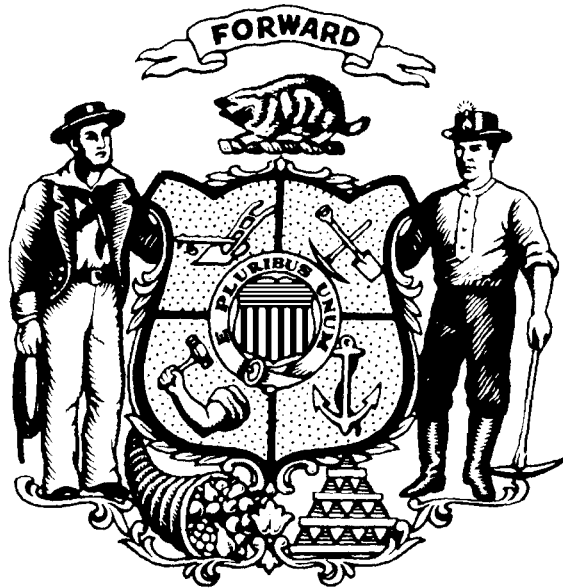


STATE OF WISCONSIN

**SUMMARY OF TAX
EXEMPTION DEVICES**

JIM DOYLE, GOVERNOR



February 2003

Division of
Executive Budget and Finance
DEPARTMENT OF ADMINISTRATION

Division of
Research and Policy
DEPARTMENT OF REVENUE

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State of Wisconsin • DEPARTMENT OF REVENUE

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Jim Doyle
Governor

Michael L. Morgan
Secretary of Revenue

January 21, 2003

To members of the 2003-04 Legislature:

Every two years, the Department of Revenue is required—under section 16.425 of the Wisconsin Statutes—to prepare a summary of existing tax exemption devices. This *Summary of Tax Exemption Devices* facilitates a comprehensive review of tax exemption devices and their corresponding fiscal effects. This type of review is important if we are to keep the revenue loss associated with current state tax exemptions in perspective.

The report represents the efforts of staff in the Department of Revenue, Division of Research and Policy. Great care has been taken to provide as accurate and complete a report as possible. The Department of Revenue hopes that members of the Legislature and others will find the document to be a useful tool in the formulation of public policy decisions. Research staff in the department stands ready to answer any questions you may have concerning material in this document.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Michael L. Morgan', with a stylized, flowing script.

Michael L. Morgan
Secretary of Revenue

INTRODUCTION

This summary of tax exemption devices describes various exemption devices and provides estimates of their fiscal effects. Mandated by section 16.425, Wis. Stats., it is the fifteenth biennial report compiled by the Department of Revenue.

The first inventory of tax exemption devices was issued in February 1975, and was limited to the individual income and corporate income and franchise taxes. The second study was expanded to include sales and use, forest crop, and real estate transfer tax exemption devices. Inheritance and gift taxes were added to the third report, and the fourth study added insurance premium and public utility taxes. The fifth report contained tax exemption devices included in Chapter 70, Wis. Stats., which basically relates to the general property tax and several relatively minor taxes applied in lieu of property taxation. Chapter 70 taxes were not included again until the tenth report, but are now included in each biennial report. The tenth report added a section on the temporary recycling surcharge, but deleted the section on inheritance and gift taxes, which were repealed as of January 1, 1992.

The original study was limited in scope because of severe data limitations and a short timeframe for its preparation. Since then, the department has undertaken samples of individual income tax returns, corporate tax returns, inheritance tax returns, and gift tax returns. These samples, and other database development efforts, have provided specific information regarding many tax exemption devices. This has significantly improved the quality of the report, although important limitations still apply to the use of fiscal estimates contained in this study.

Background

Government uses tax credits, deductions and other tax exemption devices to promote a variety of public policy goals. Some exemption devices, like the individual income tax deduction or credit for charitable contributions, are designed to encourage certain economic or social activities; others, like the deduction or credit for medical expenses, are intended to reduce taxes for persons with special circumstances.

Tax exemption devices are not, of course, the only way to achieve these policy goals. In most cases, the same objectives could be met through direct expenditure programs, legal regulation or other governmental actions. Like most governmental programs, tax exemption devices impose fiscal costs. Section 16.425, Wis. Stats., recognizes this and thus mandates this study to facilitate a comprehensive review of these exemption devices by the Governor and the Legislature.

Because the exemption devices are available to all qualified taxpayers, the fiscal costs imposed by tax exemption devices are equivalent to those of a sum sufficient expenditure program (under which payments are made on an entitlement basis to all qualified beneficiaries). Thus, as with sum sufficient appropriations, government retains no direct control over costs once a tax exemption device is enacted into law. For this reason, it is especially important that estimates of the costs of these exemption devices be made available to policy makers to provide a comprehensive picture of public policy implementation costs and alternatives.

Section 16.425 (2), Wis. Stats., defines tax exemption device to include "any tax provision which exempts, in whole or in part, certain persons, income, goods, services, or property from the impact of established taxes, including, but not limited because of failure of enumeration, to those devices known as tax deductions, tax allowances, tax exclusions, tax credits and tax exemptions." In short, they are features of the tax law which result in revenue losses by granting special tax relief.

In addition to listing tax exemption devices and estimating their fiscal impacts, the statutes require that the tax exemption report contain "policy purposes and indicators of effectiveness in achieving such purposes" for each item. Because there is no reliable way of determining what policy considerations prompted the enactment of particular tax exemption devices or of evaluating the degree to which policy goals have been met, the department has not been able to comply with this requirement. There appears to be no objective way of establishing the legislative intent in creating specific tax provisions. In fact, it is likely that individual legislators had different

motives for supporting the same measure—some based on policy perspectives and others on purely political considerations.

Measurement of Fiscal Effects

The fiscal impacts of tax exemption devices are often difficult to measure, and estimates of them are subject to serious limitations. Generally, in calculating each fiscal effect, it is assumed that only the provision in question is changed and that all other aspects of the tax system remain the same. For example, the revenue loss from an income tax deduction is calculated by adding the deduction back into taxable income and computing a new tax liability. The difference between this amount and the liability under current law is the revenue loss resulting from the deduction.

Consistent with accepted revenue estimating practices, the estimates assume that economic variables, taxpayer behavior and other factors would be unaffected by the repeal of an exemption device. For some exemption devices, these assumptions are open to question. For example, the removal of an income tax deduction could significantly alter spending or investment behavior of individuals. However, these induced effects of tax exemption provision changes are difficult to identify and evaluate, so they cannot be reflected in this report. In addition, obstacles to strict compliance may result in actual revenue gains from exemption repeal that are less than estimated liability impacts. Therefore, the elimination of a particular exemption device will not necessarily increase revenues to the extent indicated.

The methodologies used to complete the various estimates are discussed briefly in each chapter. The sources and assumptions used to make individual estimates are also shown for many exemption devices in the narrative material accompanying the fiscal estimate.

In using these fiscal estimates, several additional points should be noted. First, each estimate is made in isolation. If two or more items were eliminated, the combined effect would possibly be lesser or greater than the simple sum of the amounts shown for the individual items. This is true because various tax provisions interact with each other and a modification of one program could impact on several others. For this reason, totals of two or more estimates, or aggregates of all amounts in a given category, are not likely to be useful.

Second, all estimates are only as good as the assumptions used to complete the necessary calculations. In some cases, the estimates are very reliable because good data are available, but in others, few or no data exist and the resulting estimates are quite rough. Thus, the estimates should generally be viewed as indicative only of the order of magnitude of tax exemption device costs.

Third, in many cases, the Legislature might wish to deal with the policy goal addressed by individual exemptions through direct expenditure programs if the exemption devices were eliminated. Thus, the elimination of an exemption may result in additional revenues, but the Legislature might then spend additional funds to deal with the issue that had been met through the exemption program. The estimates included in this study do not consider the cost of such additional expenditures.

Fourth, all estimates show the impact of the various exemption devices in FY02, because this allows calculations to be made on the basis of actual income, sales and other relevant data (rather than relying on less accurate projections). Changes in taxpayer behavior or economic activities since that time are not reflected in the fiscal estimates.

INDIVIDUAL INCOME TAX

Introduction

The individual income tax is Wisconsin's largest tax source, generating \$4,980 million, or nearly 50% of state general purpose revenue taxes in FY02. Wisconsin first enacted its income tax in 1911—two years before the federal income tax was imposed.

Wisconsin imposes the income tax on a base that generally conforms to the base for the federal income tax—federal adjusted gross income (FAGI) is the starting point for the Wisconsin tax calculation. FAGI is calculated on the federal return by reporting the various kinds of income—for instance, wages and salaries, interest and dividends, business earnings, retirement income—and then making adjustments for certain kinds of income or expenses. Major adjustments include:

- Contributions to individual retirement accounts and to retirement plans of self-employed persons.
- Deduction for a percentage of health insurance premiums paid by the self-employed—the percentage was 60% for tax year 2001 and rises to 70% for 2002 and 100% for 2003 and thereafter.
- One-half of the self-employment tax paid for social security and Medicare coverage.
- Up to \$2,500 in interest on student loans when income is less than \$50,000 for single persons and \$100,000 for married couples. The deduction phases out as income rises to \$65,000 for single persons and \$130,000 for couples.
- Alimony paid, to the extent the payments are included in the income of the recipient. Child support and property settlements are not considered alimony.

In the Wisconsin tax calculation, modifications, both additions and subtractions, are made to FAGI in the determination of Wisconsin adjusted gross income (WAGI). Additions are types of income that are exempt from federal tax but subject to state tax, or deductions allowed for federal but not Wisconsin purposes. The major addition is state and municipal bond interest, which states, but not the federal government, may tax. Another addition results from differences in the amount of capital losses that taxpayers may offset against income—\$3,000 under federal law, but \$500 under Wisconsin law. Taxpayers who deduct more than \$500 in losses for federal purposes must add back the excess in calculating WAGI. A federal deduction not allowed for Wisconsin purposes that must be added back in the calculation is the deduction for higher education expenses that will be allowed from 2002 through 2005. Wisconsin did not adopt the federal deduction because it has its own tuition deduction.

Subtractions are types of income taxable under federal law but exempted by Wisconsin and certain expenses for which Wisconsin allows a deduction. Major subtractions include:

- 60% of capital gains on assets held for more than one year. These gains are fully included in federal taxable income, though long-term gains are taxable at lower rates than ordinary income.
- Interest on U.S. government bonds, which the federal government may, but states may not, tax.
- Pensions received by persons who were members of or retired from Milwaukee City and county retirement funds, the state teachers' retirement fund and the civil service retirement system prior to January 1, 1964. In addition, veterans' pensions are exempt from Wisconsin income tax, so they too are subtracted from FAGI in determining WAGI.
- A portion of social security benefits that are taxable for federal purposes. Up to 85% of social security benefits are subject to federal tax, but Wisconsin limits the amount taxed to 50% of benefits.
- A portion of unemployment compensation, which is fully taxable under federal but taxed by Wisconsin only when income exceeds \$18,000 for married couples and \$12,000 for most other filers.

- Tuition payments, up to \$3,000 per student, to post-secondary institutions in Wisconsin and to schools in Minnesota covered under Minnesota-Wisconsin tuition reciprocity.
- The full amount of health insurance premiums paid by the self-employed and 50% of premiums paid by employed persons whose employer does not contribute to their health insurance. Since federal law allowed a deduction in 2001 for 60% of premiums paid by the self-employed and since Wisconsin allows this federal deduction by using FAGI as the starting point of its tax calculation, the Wisconsin subtraction is limited to the remaining 40% of premiums not deducted for federal purposes.
- Premiums paid for long-term care insurance.

WAGI is reduced by a standard deduction and personal exemptions to yield Wisconsin taxable income. Wisconsin provides a sliding scale standard deduction, equal to some maximum when income is below a specified level; this maximum deduction is phased down to \$0 as income increases. For instance, in 2001, the deduction for single persons was \$7,440 when WAGI was less than \$10,730, and it declined to \$0 as income increased from \$10,730 to \$72,370. The deduction parameters for each of Wisconsin's filing statuses are shown in Table 1; the maximum deduction and phase-out range are indexed annually for inflation. Unlike federal law, Wisconsin does not allow itemized deductions; instead it provides an itemized deductions credit, discussed below, equal to 5% of certain deductions in excess of the standard deduction.

TABLE 1
WISCONSIN STANDARD DEDUCTIONS, 2001

| Filing Status | Maximum Deduction | Phase-Out Range | Phase-out Rate |
|---------------------------|-------------------|----------------------|----------------|
| Single | \$7,440 | \$10,730 - \$72,730 | 12% |
| Head of Household | \$9,620 | \$10,730 - \$31,460* | 22.515% |
| Married Filing Jointly | \$13,410 | \$15,070 - \$82,872 | 19.778% |
| Married Filing Separately | \$6,370 | \$7,520 - \$39,367 | 19.778% |

* Income at which head of household deduction equals the deduction for single filers. Above this income level, the deduction for heads of households is the same as that for single persons.

WAGI is also reduced by a personal exemption equal to \$700 for each tax filer, spouse and dependent. There is an additional exemption of \$250 for each tax filer and spouse age 65 or older.

Wisconsin taxable income, equal to WAGI less the standard deduction and personal exemptions, is the base to which statutory tax rates are applied to yield gross tax liability. As Table 2 shows, Wisconsin imposed a series of graduated tax rates, ranging from 4.6% to 6.75%. The top rate applies only to filers with substantial amounts of income—in 2001, on income exceeding \$116,330 for single persons and \$155,100 for married couples filing jointly.

TABLE 2
WISCONSIN TAX RATES AND BRACKETS, 2001

| Tax Rate | Taxable Income Brackets | | |
|----------|-------------------------|----------------------|---------------------|
| | Single | Married - Joint | Married - Separate |
| 4.60% | \$0 - \$8,060 | \$0 - \$10,750 | \$0 - \$5,380 |
| 6.15% | \$8,061 - \$16,130 | \$10,751 - \$21,500 | \$5,381 - \$10,750 |
| 6.50% | \$16,131 - \$116,330 | \$21,501 - \$155,100 | \$10,751 - \$77,550 |
| 6.75% | More than \$116,330 | More than \$155,100 | More than \$77,550 |

Finally, gross tax is reduced by credits against the tax liability. Major nonrefundable credits, which are limited to the amount of income tax liability otherwise due, include:

- The itemized deductions credit, equal to 5% of the amount by which certain federal itemized deductions exceed the standard deduction. Deductions allowed for the credit are those for medical expenses, mortgage interest (limited to a primary residence located in Wisconsin), investment interest on securities the income from which is subject to Wisconsin tax, and charitable contributions.
- The school property tax credit, equal to 12% of the first \$2,500 of property taxes, or rent constituting property taxes, for a maximum credit of \$300. Rent constituting property taxes equals 20% of rent if heat is included in rent, and 25% if heat is not included.
- The working families credit, which eliminated tax liability below \$18,000 for married couples filing jointly and \$9,000 for other tax filers and which is phased out over the next \$1,000 of income above these amounts.
- The married couple credit for couples when both spouses are working, equal to 3% of the earnings of the lower earning spouses, but not more than \$16,000, resulting in a maximum credit of \$480.
- The credit for military income earned outside the United States, equal to the amount of those earnings, but no more than \$200.
- Historic rehabilitation credits, including a supplement to the federal historic rehabilitation credit equal to 5% of qualifying expenditures under the federal Internal Revenue Code and a state historic rehabilitation credit equal to 25% of qualified expenditures to substantially rehabilitate certified historic buildings.
- A credit for income taxes paid to other states on wages or other earnings in those states. No credit is allowed for states with which Wisconsin has reciprocity, that is, agreements under which each state agrees not to tax the wages earned within its borders by residents of the other state. Wisconsin has reciprocity agreements with Illinois, Indiana, Kentucky, Michigan and Minnesota. Because the number of Wisconsin residents working in Illinois and Minnesota is substantially higher than the number of residents of those states working in Wisconsin, Wisconsin annually makes a payment to those states to compensate them for the net revenue loss they incur as a result of reciprocity.

Individual income taxpayers are also eligible for business tax credits for sales tax on fuel and electricity used in manufacturing and for activities in developments zones. These credits are described more fully in the corporate income and franchise tax chapter.

In addition to nonrefundable tax credits, Wisconsin also offers refundable credits, which are paid to claimants in the form of a tax refund check when the amount of the credit exceeds tax otherwise due. These credits are essentially subsidies provided to particular types of claimants through the tax system. These credits are:

- The Homestead credit, which equals up to 80% of property taxes or rent constituting property taxes when household income does not exceed \$8,000. Maximum property taxes allowable under the credit are \$1,450, so the maximum credit is \$1,160. The credit is phased out as household income rises from \$8,000 to \$24,500. Rent constituting property taxes equals 20% of rent when heat is included in rent and 25% of rent when heat is not included.
- The earned income tax credit (EITC), calculated as a percentage of the federal earned income tax credit depending on family size: 4% for persons with one child, 14% for persons with two children and 43% for persons with three or more children. In 2001, the federal credit for persons with one child was equal to 34% of earnings up to \$7,140, for a maximum credit of \$2,428; the credit was phased out as the greater of FAGI or earnings rose from \$13,090 to \$28,281. For persons with two or more children, the federal credit was 40% of earnings up to \$10,020, for a maximum credit of \$4,008, and the credit was phased out as income or earnings rose from \$13,090 to \$32,121. Thus, the maximum Wisconsin credits were \$97 for persons with one child, \$561 for persons with two children and \$1,723 for persons with three or more children.

- The farmland preservation credit for owners of farmland that was zoned exclusively for agriculture use or covered under a farmland preservation agreement with the state. The credit is calculated by determining “excessive property tax” on land and improvements, which is the amount of property taxes less a portion of household income in excess of \$5,000 (ranging from 7% of household income between \$5,000 and \$10,000 to 37% of household income in excess of \$30,000). “Excessive property tax” is limited to \$6,000 and the potential credit is equal to 90% of the first \$2,000 of excessive property taxes, 70% of the next \$2,000 and 50% of the remaining \$2,000, for a maximum potential credit of \$4,200. The amount of credit actually received is 70%, 80%, 95% or 100% of the potential amount, depending on whether the claimant participates in the farmland preservation program through zoning or a contract and depending on the action taken on a farmland preservation plan or zoning by the county or municipality in which the farmland is located. The minimum credit is 10% of potential property tax.
- The farmland tax relief credit equal to a percentage, determined by the Department of Revenue, of the first \$10,000 of property taxes on farmland exclusive of improvements. The credit percentage is established so that total annual credits for individual and corporate farm owners equal \$15 million; the percentage for tax year 2001 was 13%, for a maximum credit of \$1,300.

In addition to this regular tax, Wisconsin imposes an alternative minimum tax that may limit the benefit of some tax exemption devices. The alternative minimum tax is equal to 6.5% of alternative minimum taxable income above the applicable exemption amount (\$33,750 if single, \$45,000 if married filing a joint return and \$22,500 if married filing a separate return).

Estimates of Fiscal Effects

Estimates of individual income tax exemption devices are provided in Table 3. Descriptions of each device follow the table. The table identifies the exemption devices, indicates the statutory section allowing the exemption device and provides an estimate of its fiscal effect in FY02.

Several approaches were used to generate the estimates shown in Table 3. The estimates of exclusions from gross income, which are not reported on tax returns, were generally based on estimates of the fiscal effect of federal tax expenditures—i.e., federal tax exemption devices—contained in the annual budget document issued by the Executive Office of the President. In addition, estimates prepared by the Congressional Budget Office and the staff of the Joint Committee on Taxation were also considered. Generally, Wisconsin's share of the federal fiscal effect was determined using the state's share of total federal adjusted gross income on all federal tax returns, and then adjustments were made to account for the differences in federal and Wisconsin tax rates.

Most of the other estimates were based on Wisconsin-specific data sources, including the 2001 Wisconsin individual income tax model, aggregate statistics from the 2001 tax processing year, and tax collection statistics from FY02. The tax model is derived from a scientifically stratified sample of approximately 20,000 tax returns, weighted to reflect the statewide population of tax filers in 2001. This model was used to simulate the effect of tax exemption devices for which data is captured in the sample. The aggregate statistics were drawn from tax returns processed from July 1, 2001 to June 30, 2002.

TABLE 3
INDIVIDUAL INCOME TAX EXEMPTION DEVICES SUMMARY

| Exemption Device | Statutory Reference* | FY02 Fiscal Effect |
|---|---|--------------------|
| Exclusions from Gross Income | | |
| Gain from Sale or Exchange of Residence (Home) | IRC 121 | \$121,000,000 |
| Social Security Benefits | IRC 86 | 147,000,000 |
| Railroad Retirement Annuities and Pensions | IRC 86 | 2,000,000 |
| Public Assistance | IRC 61 | 2,100,000 |
| Sickness and Injury Benefits | IRC 104 to 106 | 607,000,000 |
| Group Term Life Insurance Purchased for Employees | IRC 79 | 31,000,000 |
| Death Benefits | IRC 101 | 44,000,000 |
| Meals and Lodging to Employees | IRC 119 | 4,500,000 |
| Scholarships and Fellowships | IRC 117 | 7,500,000 |
| Awards and Prizes | IRC 74 (b) and (c) | Minimal |
| Payments to Victims of Nazi Persecution | IRC 61 (P.L. 107-16, Section 803) | Minimal |
| Rental Value of Parsonages | IRC 107 | 2,300,000 |
| Reduced Armed Forces Retirement Pay | IRC 122 | Not available |
| Combat Pay and Other Armed Forces Exclusions | IRC 112 and 134 | 34,000,000 |
| Life Insurance Dividends | IRC 7702 | 27,000,000 |
| Cancellation of Business Property Indebtedness | IRC 108 (a) | Minimal |
| Income Realized from Debt Cancellation Through Bankruptcy | IRC 108 | Not available |
| Interest on Certain State and Local Bonds | ss. 66.1201 (14)a, 66.1333 (5)(a)4.c and 71.05 (1)(c) | Not available |
| Gifts and Inheritances | IRC 102 | Not available |
| Appreciation of Property Held at the Time of Death | IRC 1014 | 68,000,000 |
| Employer Contributions to Pension Plans and Net Pension Fund Earnings | IRC 401 to 404A, 406 to 407 and 409 to 417 | 605,000,000 |
| Employer Reimbursement of Employee's Educational Expenses | IRC 127 | 2,300,000 |
| Employer-Provided Child Care | IRC 129 | 4,600,000 |
| Employer-Provided Adoption Assistance | IRC 137 | 200,000 |
| Transportation and Other Fringe Benefits | IRC 132 (a) | 15,500,000 |
| Foster Care Payments | IRC 131 | 800,000 |
| Cancellation of Student Loans | IRC 108 (f) | Minimal |
| Recovery of Tax Benefit Items | IRC 111 | Minimal |
| Foreign Earned Income | IRC 911 | 15,600,000 |
| Natural Resource-Related Cost-Sharing Payments | IRC 126 | Minimal |
| Passive Activity Losses | IRC 469 | 4,400,000 |
| Adjustments to Gross Income | | |
| Capital Losses | IRC 1211; s 71.05 (10)(c) | 5,600,000 |
| Losses from the Sale or Exchange of Business Property | IRC 62 (a)(3) | 4,300,000 |
| Pension, Profit-Sharing, Annuity and Bond Purchase Plans of Self-Employed Individuals | IRC 62 (a)(6) | 11,600,000 |
| Individual Retirement Accounts (IRAs) | IRC 62 (a)(7), 219, 408, 408A, and 530 | 9,700,000 |
| Deduction for Higher Education Expenses | IRC 222 | None |
| Student Loan Interest | IRC 221 | 3,700,000 |
| Self-Employment Tax | IRC 164 (f) | 16,500,000 |
| Health Insurance of Self-Employed Persons | IRC 162 (l) | 8,800,000 |
| Medical Savings Accounts | IRC 220 | 280,000 |
| Moving Expenses | IRC 217 | 800,000 |
| Alimony | IRC 62 (a)(10), 71 and 215 | 8,300,000 |
| Penalty on Early Withdrawal of Savings | IRC 62 (a)(9) | 140,000 |

TABLE 3
INDIVIDUAL INCOME TAX EXEMPTION DEVICES SUMMARY (continued)

| Exemption Devices | Statutory Reference* | FY02 Fiscal Effect |
|---|-----------------------------------|--------------------|
| Modifications to Federal Adjusted Gross Income | | |
| Social Security Benefits: Difference in State and Federal Treatment | s. 71.05 (6)(b)21 | 40,000,000 |
| Interest on U.S. Obligations | s. 71.05 (6)(b)1 | 21,000,000 |
| Capital Gains Deduction | s. 71.05 (6)(b)9 | 180,000,000 |
| Capital Gains from Qualified Small Business Stock | s. 71.05 (6)(b)6 | Not available |
| Gains on Sales of Business Assets to Related Persons | s. 71.05 (6)(b)25 | 650,000 |
| Net Long-Term Capital Losses (Pre-1982) | s. 71.05 (14) | Minimal |
| Public Pensions | s. 71.05 (1)(a), (am) and (an) | 52,500,000 |
| State Legislators' Per Diem Expenses | s. 71.05 (1)(b) | 80,000 |
| Small Business (Subchapter S) Corporation Subtractions | s. 71.05 (10)(b) | Not available |
| Distributive Share of Estates and Trusts | s. 71.05 (4) | Not applicable |
| Distributive Share of Partnership Modifications | s. 71.05 (9) | Not applicable |
| Wisconsin Net Operating Loss Carryover | s. 71.05 (8) | 2,200,000 |
| Health Insurance Premiums of the Self-Employed and Certain Employees: Difference in State and Federal Treatment | s. 71.05 (6)(b)19 and 20 | 6,600,000 |
| Long-Term Care Insurance Expenses | s. 71.05 (6)(b)26 | 3,200,000 |
| Constant Basis Assets | s. 71.05 (13)(b) | Minimal |
| Adjusted Basis of Assets Acquired after January 1, 1965 | s. 71.05 (19) and (20) | Minimal |
| Unemployment Compensation | s. 71.05 (6)(b)8 | 3,200,000 |
| Disability Income | s. 71.05 (6)(b)4 | Minimal |
| Adoption Expenses | s. 71.05 (6)(b)22 | Minimal |
| Higher Education Tuition Expenses | s. 71.05 (6)(b)28 | 12,800,000 |
| Prepaid Tuition and College Savings Plans | s. 71.05 (6)(b)23 and 31 to 33 | 2,000,000 |
| Viatical Settlement Contracts | s. 71.05 (1)(f) | Minimal |
| Payments to Victims of Nazi Persecution | s. 71.05 (6)(b)30 | None |
| Deductions and Exemptions from Adjusted Gross Income | | |
| Sliding Scale Standard Deduction | s. 71.05 (22) | 520,000,000 |
| Personal Exemption and Additional Elderly Exemption | s. 71.05 (23) | 186,000,000 |
| Credits | | |
| Itemized Deductions Credit | s. 71.07 (5) | 283,000,000 |
| School Property Tax Credit | s. 71.07 (9) | 348,000,000 |
| Working Families Credit | s. 71.07 (5m) | 1,000,000 |
| Married Couple Credit | s. 71.07 (6) | 269,000,000 |
| Armed Forces Member Credit | s. 71.07 (6m) | 700,000 |
| Credit for Sales Tax on Fuel and Electricity Used in Manufacturing | s. 71.07 (3s) | 9,000,000 |
| Development Zone Credits | s. 71.07 (2dm) and (2dx) | 1,800,000 |
| Campaign Fund Tax Credit | s. 71.07 (6s) | None |
| Historic Preservation Credits | s. 71.07 (9m) and (9r) | 1,150,000 |
| Earned Income Credit | s. 71.07 (9e) | 62,700,000 |
| Homestead Credit | ss. 71.07 (4), 71.51 to 71.55 | 104,400,000 |
| Income Taxes Paid to Other States/Income Tax Reciprocity | ss. 71.07 (7), 71.10 (7) and (7e) | 135,300,000 |
| Claim of Right Credit | s. 71.07 (1) | Minimal |
| Farmland Tax Relief Credit | s. 71.07 (3m) | 13,300,000 |
| Farmland Preservation Credit | ss. 71.07 (3) and 71.57 to 71.61 | 16,500,000 |

Table 3
INDIVIDUAL INCOME TAX EXEMPTION DEVICES SUMMARY (continued)

| Exemption Devices | Statutory Reference* | FY02 Fiscal Effect |
|---|----------------------|--------------------|
| Deductions Which Further Define Net Income | | |
| Trade and Business Expenses | IRC 62 (a)(1) | Not applicable |
| Employee's Trade and Business Expenses | IRC 62 (a)(2) | Not applicable |
| Expenses Related to Rent and Royalty Income | IRC 62 (a)(4) | Not applicable |

* References to sections of the 2001 Wisconsin Statutes, except "IRC" indicates a reference to a section of the federal Internal Revenue Code authorizing the exemption device.

EXCLUSIONS FROM GROSS INCOME

An exclusion is a type of income that is not included in federal gross income by provisions of the Internal Revenue Code or under the U. S. Constitution, or in Wisconsin income by provisions of the Wisconsin Statutes. Excluded income does not have to be reported on the income tax return.

Gain from Sale or Exchange of Residence (Home)

A taxpayer may exclude from income up to \$250,000 (\$500,000 for married couples filing jointly) of capital gain realized on the sale or exchange of a residence. The taxpayer must have owned and occupied the home as a principal residence for at least two of the five years prior to the sale. An individual not meeting the ownership or residence requirements is allowed a pro rata amount of the exclusion if the sale or exchange is due to a change in employment, health, or other unforeseen circumstances. The exclusion is allowed on only one sale every two years, and it is not permitted on properties in which depreciation is allowed for rental or business use.

Social Security Benefits

Old-age and survivors insurance benefit payments, state old-age assistance payments and Medicare benefits are generally excluded from the gross income of the person receiving such benefits. Federal law subjects up to 50% of benefits to tax when income exceeds a "base amount" and up to 85% of benefits when income exceeds an adjusted base amount. In this determination, income equals modified adjusted gross income plus one-half of social security.

The base amounts, for determining tax on up to 50% of benefits, are \$25,000 for single persons, including married persons filing separately who lived apart from their spouses for the full tax year; \$32,000 for married couples filing a joint return; or \$0 for married persons filing separately who lived with their spouses for at least part of the year. The adjusted base amounts, for taxing up to 85% of benefits, are \$34,000 for single persons, \$44,000 for married couples and \$0 for married persons filing separately and living with their spouses for at least part of the year.

Wisconsin only partially follows the federal treatment. The state taxes up to 50% of social security benefits, since it chose not to adopt the federal increase to 85% in the maximum amount taxable when it was enacted in 1994. The table provides separate fiscal estimates of the state revenue loss resulting from the federal exclusion and the loss resulting from the state modification to FAGI that limits the amount of social security benefits subject to tax to 50%, rather than 85%, of the total.

Railroad Retirement Annuities and Pensions

Annuities or pensions paid under the 1935 and 1937 Railroad Retirement Acts are generally excluded from gross income. Up to 50% of Tier 1 retirement benefits are taxable for federal tax purposes, but the Railroad Retirement Acts specifically prohibit state taxation of retirement benefits, so Tier 1 benefits are completely excluded from gross income for state purposes.

Public Assistance

Assistance provided under the Wisconsin Works program, Medicaid, general relief and other public assistance to individuals and families are excluded from the gross income of the recipients.

Sickness and Injury Benefits

Compensation for sickness or personal injury excluded from gross income includes the following:

- Amounts received under the worker's compensation and social security acts,
- Damages received as a result of a court suit or other legal settlement in a personal injury case,
- Proceeds received from an accident, health or medical insurance policy paid for by the taxpayer,
- A pension, annuity or similar allowance for sickness or injury sustained while active in the armed forces, the Coast and Geodetic Survey, the Public Health Service or the Foreign Service, and disability income received by an employee of the United States for injuries incurred in a terrorist attack during the performance of duties outside the U. S.
- Employer contributions to an accident or health plan designed to benefit the employee, and
- Sick pay or employer-financed disability benefits, other than reimbursement for medical expenses deducted in the same year or a prior year, which is regarded as taxable income.

Group Term Life Insurance Purchased for Employees

The cost of group term life insurance provided to an individual under a policy carried by an employer is generally considered taxable income. However, the cost incurred in purchasing the first \$50,000 worth of coverage is excluded from the gross income of employees.

Death Benefits

Two types of payments made to survivors of a deceased individual are excluded from gross income. First, amounts paid under a life insurance contract are excluded whether these sums are paid at one point or over time. Second, up to \$5,000 of death benefits paid by an employer to a beneficiary are similarly disregarded for tax purposes.

Meals and Lodging to Employees

Employees may exclude from gross income the value of any meals or lodging provided to them for the convenience of the employer. Meals must be furnished on the employer's business premises and lodging must have been accepted by an employee as a condition of employment.

Scholarships and Fellowships

Scholarships and fellowships are excluded from gross income when received by a degree candidate at an educational institution and when used to pay tuition and course-related fees or to purchase books, equipment and supplies. Amounts used for room and board, however, must be included in income. Scholarships and fellowships do not qualify for the exclusion if they are made either to compensate the recipient for services provided, or to allow the recipient to pursue studies or research that primarily benefit the person or institution paying the scholarship and fellowship.

Awards and Prizes

Awards or prizes received in recognition of religious, charitable, scientific, educational, literary or civic achievement may be excluded from gross income if the amount received is transferred to a government agency or a charitable organization. Further, the exclusion applies only if the recipient was selected without any action on his or her part to enter the competition for the award and only if the recipient is not required to render any substantial future services as a condition of receiving the award.

Employee awards for length of service or achievement are generally excludable from gross income to the extent of the deduction claimed by the employer. Deductions of such awards are limited.

Payments to Victims of Nazi Persecution

Restitution payments received by persons persecuted by Nazi Germany or countries allied to it or received by their heirs or estates are excluded from gross income.

Rental Value of Parsonages

The allowance paid to a minister for the purpose of renting a home, or the rental value of the home furnished as part of compensation, is excluded from gross income. In both cases, the associated utility expenses are considered part of the allowance and, as such, excluded from gross income.

Reduced Armed Forces Retirement Pay

The amount deducted from retirement or retainer pay of members or former members of the United States Armed Forces under the Retired Serviceman's Family Protection Plan is excluded from gross income. The reduction in retirement pay is made by contract between the member of the service and the Armed Forces for the purchase of an annuity. This reduction is between 12.5% and 50% of retirement pay, but in no case less than \$25. If the person should die before the amount of the contract is paid, the survivor receiving the annuity may exclude from gross income any reductions in annuity payments used to conclude the contract.

Combat Pay and Other Armed Forces Exclusions

The monthly compensation of members of the United States Armed Forces is excluded from gross income if the taxpayer served in a combat zone. The exclusion for commissioned officers is limited to the maximum amount that enlisted personnel may exclude. Currently designated combat zones and hazardous duty areas include:

- Afghanistan, along with Uzbekistan, Kyrgystan, Pakistan, Tajikistan, and Jordan;
- the Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the Ionian Sea north of the 39th parallel;
- Bosnia, Herzegovina, Croatia, and Macedonia; and
- the Persian Gulf, the Red Sea, the Gulf of Oman, the part of the Arabian Sea that is north of 10 degrees north latitude and west of 68 degrees east longitude, the Gulf of Aden, and the total land areas of Iraq, Kuwait, Saudi Arabia, Oman, Bahrain, Qatar, and the United Arab Emirates.

Exclusions applicable to miscellaneous Armed Forces income are:

- All payments of benefits under any law administered by the Veterans' Administration (38 U. S. Code 3101);
- A pension of \$100 per month for all persons over the age 65 who are on the Army, Navy, Air Force, or Coast Guard Medal of Honor roll (38 U. S. Code 562);
- Benefits under World War Adjusted Compensation Act;
- Benefits under World War Veteran's Act;
- Leave compensation payment under Armed Forces Leave Act;
- G.I. Bill educational benefits;
- In-kind benefits provided to armed forces personnel.

Life Insurance Dividends

Dividends on matured insurance policies may be excluded from gross income for income tax purposes.

Cancellation of Business Property Indebtedness

A taxpayer need not recognize income when a debt of the taxpayer is fully or partially canceled if the individual incurred the debt in connection with property used in a trade or business. The taxpayer must agree to reduce the basis (cost) of the property if an economic benefit was realized as a result of the discharge of a debt for the purpose of determining future depreciation and capital gains or losses.

Income Realized from Debt Cancellation Through Bankruptcy

When a debt is forgiven in connection with a bankruptcy proceeding, the income realized is not subject to tax unless the principal purpose of the bankruptcy plan is the evasion of income taxes.

Interest on Certain State and Local Bonds

In general, interest on obligations of state and local governments is subject to the Wisconsin income tax, even though such income may be exempt from federal taxation. However, interest on the following bonds is exempt: bonds issued by city housing authorities, city redevelopment authorities, local exposition districts and local cultural arts districts; bonds issued by the Wisconsin Housing and Economic Development Authority (WHEDA) before January 29, 1987 (except business development, economic development, and housing revenue bonds); Wisconsin professional baseball park and football stadium district bonds; Wisconsin Housing Finance Authority (WHFA) bonds (that is, bonds issued before 1983, when WHFA became known as WHEDA); and Wisconsin higher education bonds.

Gifts and Inheritances

The value of property received by gift, inheritance, devise or bequest is excluded from gross income. This exclusion does not apply to the income from property received by gift or bequest nor to a gift or bequest consisting of income from property rather than the property itself.

No data are available on the total value of property transferred by gift or inheritance, so no estimate of the revenue loss can be made. Property transferred at death, for deaths occurring after September 30, 2002, is subject to the Wisconsin estate tax when the value of the estate exceeds \$675,000. Only about 2% of all estates are subject to this tax; however, they account for a substantially larger share of the total value of property transferred at death, since they are the very largest estates. The fiscal effect in FY02 of the income tax exclusion for these largest estates was approximately \$100 million. Wisconsin estate taxes paid by these estates during FY02 were \$83 million.

Appreciation of Property Held at the Time of Death

Appreciation (gain) from property held at the time of death is not subject to tax for either the deceased or his or her heirs. The basis of inherited property generally is its fair market value at the time of the decedent's death, rather than its cost when the decedent acquired it. As a result, the appreciation of the property while it was held by the decedent—the difference in fair market value at the time of death and the decedent's cost of purchasing the property—is not taxed.

With the repeal of the federal estate tax in 2010, this exclusion will be eliminated in that year. The basis of the property for the heir will be the decedent's basis of the property, so the appreciation of the property while it was owned by the decedent will be taxable income for the heir when he or she sells the property. Under current federal law, the repeal of the federal estate tax and the change in basis rules for property transferred at death are sunsetted after 2010—the estate tax and the current basis rules will be reinstated, barring further changes in federal law.

The \$68 million revenue loss from this exclusion reflects the effect of Wisconsin's 60% exclusion for long-term capital gains. If Wisconsin fully taxed capital gains, the fiscal effect would total \$170 million.

Employer Contributions to Pension Plans and Net Pension Fund Earnings

Amounts contributed to qualified pension, profit-sharing, stock bonus, bond purchase and annuity plans by an employer on behalf of his or her employees are generally not treated as income taxable to the employees at the time the contributions are made. Further, employers may generally deduct these contributions from gross income, and the earnings that accrue on the contributions are excluded from the employee's income, so long as the assets are retained within a qualified plan.

Tax is imposed when distributions are made from the plan to employees in the form of pensions and annuities. At that time the taxable portion of the plan benefits must be included in the gross income of the recipient. The portion of the benefits representing the employee's contribution to the plan is not taxable upon distribution if the employee's contributions were already included in income and subject to tax at the time the contributions were made.

Taxing employer contributions and earnings on pension plan assets at the time of withdrawal, rather than at the time of contribution, results in a revenue loss if the plan beneficiary pays tax at a lower rate when retired than when working.

Employer Reimbursement of Employee's Educational Expenses

Up to \$5,250 of non-job related employer-provided educational assistance may be excluded from gross income.

Employer-Provided Child Care

The value of child or dependent care services provided by an employer under a nondiscriminatory plan is excluded from gross income to the extent that the amount excluded does not exceed \$5,000. Further, the value of services excluded may not exceed the earned income of the employee or the earned income of an employee's lower-earning spouse.

Employer-Provided Adoption Assistance

For tax year 2001, up to \$5,000 per child in adoption assistance provided by an employer was excluded from gross income. For children with special needs, the maximum that could be excluded was \$6,000. The exclusion was phased out for persons with federal adjusted gross income between \$75,000 and \$115,000. Beginning in 2002, the maximum is raised to \$10,000 per child for all adoptions and the phase-out range is increased to \$150,000 to \$190,000. Beginning in 2003, a \$10,000 exclusion is allowed for special needs adoption even if that amounts exceeds actual expenses incurred.

Transportation and Other Fringe Benefits

Employer-provided transportation in a commuter vehicle, transit passes and parking are excluded from income of the employee receiving these benefits. The exclusion for commuter transportation or transit passes is limited to \$65 per month in 2001 and \$100 per month in 2002; the exclusion for parking is limited to \$180 per month in 2001 and \$185 per month in 2002. These amounts are indexed for inflation.

Other fringe benefits excluded from income includes services provided by employers to employees at no additional cost to the employer, employee discounts, property or services for which an employee would be allowed a deduction if the employee provided that property or service, property or service of minimal value, reimbursement of moving expenses, and retirement planning services. Only the transportation benefits have a measurable fiscal effect.

Foster Care Payments

Foster care payments to care providers by a state or local government or a foster care placement agency are excluded from income.

Cancellation of Student Loans

The amount of a student loan funded by federal, state or local government programs that has been forgiven is not included in taxable income when the cancellation is contingent upon the beneficiary working for a specified period of time in a certain area or for a particular type of employer.

Recovery of Tax Benefit Items

Income from the recovery of an amount for which a tax deduction or other benefit was claimed during the previous year is not included in income if the deduction did not reduce income tax liability in that previous year. However, if the deduction led to reduced tax liability in a prior year, then the recovery is taxable. An example of a recovered tax benefit item is a debt that is written off in one year but received in a later year.

Foreign Earned Income

Qualified individuals who work abroad and receive earned income from foreign sources may elect to exclude up to \$78,000 of such income in 2001 and \$80,000 in 2002 and thereafter. The exclusion amount is adjusted to take into account employer-provided housing allowances, or housing expenses, where allowances are not provided, and the maximum exclusion is reduced for taxpayers who work abroad for only part of a year.

Natural Resource-Related Cost-Sharing Payments

Payments received by individuals primarily for the purpose of conserving soil and water resources, protecting or restoring the environment, improving forests, or providing a habitat for wildlife, may be excluded from gross income.

Passive Activity Losses

In general, when the deductions exceed the income from a business activity, the resulting loss can be offset against other types of income. However, passive activity losses—those from business activities in whose management or operation taxpayers do not actively or materially participate—are subject to passive loss restrictions. Under the restrictions, passive losses can only be offset against other passive income. Passive losses subject to the restrictions are suspended and carried forward indefinitely until used against other passive income or until the taxpayer disposes of the ownership interest in the passive business activity in a fully taxable transaction.

Certain activities are explicitly treated by the tax code as either passive or active. For example, interest, dividends, annuities, royalties and other portfolio income are not treated as income from a passive activity, so net losses generated from passive activities cannot be used to offset portfolio income.

A rental activity generally is treated as a passive activity, though a limited exception exists for rental activity losses incurred by a taxpayer who actively participates in the rental real estate venture and owns at least a 10% interest in the rental property. Under the exception, up to \$25,000 of losses from rental real estate may be used to offset income from nonpassive sources. The \$25,000 maximum is reduced (but not below zero) when the taxpayer's adjusted gross income exceeds \$100,000, and is completely phased out when AGI exceeds \$150,000. Special rules apply for married taxpayers who file separate returns and live apart. A taxpayer with a working interest in oil and gas activities is also exempt from the passive loss rules.

ADJUSTMENTS TO GROSS INCOME

An adjustment is an amount subtracted from gross income to arrive at adjusted gross income. Adjustments are normally characterized as "business" (rather than "personal") expenses.

Capital Losses

Losses from the sale or exchange of capital assets may be used to offset gains from capital assets. If the amount of capital losses exceeds the amount of capital gains in the current year, the net capital loss may be used to offset up to \$500 of ordinary income for Wisconsin tax purposes (under federal law, the offset is limited

to \$3,000). The amount of net capital loss not allowed as a deduction in the current year may be carried forward to future years offset capital gains or ordinary income up to the \$500 limit, up to 15 years.

Wisconsin treatment of long-term losses incurred prior to tax year 1982 also differs from the federal treatment. The Wisconsin modification for these pre-1982 long-term losses is described in the section on "Modifications to Federal Adjusted Gross Income."

Losses from the Sale or Exchange of Business Property

Losses incurred from the sale or exchange of property used in a business are deductible.

Pension, Profit-Sharing, Annuity, and Bond Purchase Plans of Self-Employed Individuals

A self-employed taxpayer may deduct from gross income contributions made on the taxpayer's behalf to a pension, profit-sharing, annuity, or bond purchase plan. Contributions must be made from earned income.

Individual Retirement Accounts (IRAs)

Taxpayers may receive tax benefits from three different types of individual retirement accounts under federal law: the traditional IRA, the Roth IRA and the education IRA.

1. Traditional IRA

Persons contributing to a traditional IRA may claim a deduction for the amount contributed and are not taxed on the earnings that remain in a traditional IRA. IRA contributions and earnings on them are taxable when withdrawals are made from the account.

The deduction for contributions is limited to persons who are not covered by an employer-provided retirement plan or who are covered by such plans but has adjusted gross income, for tax year 2001, less than \$33,000 for single persons, \$53,000 for married persons filing jointly or \$0 for married persons filing separately. These income ceilings are being increased each tax year through 2007. The deduction is phased out over the next \$10,000 of income.

For tax year 2001, the deduction is generally limited to \$2,000 for each tax filer and spouse, but not more than the person's earnings. For married couples, the combined IRA deduction may not exceed combined earnings; in other words, a spouse with little or no earnings may still claim an IRA deduction if the other spouse has earnings in excess of his or her own IRA deduction. These maximum contributions are coordinated among the three types of IRAs; the combined contribution to all IRAs for any one person cannot exceed \$2,000 or the person's earnings. The maximum contribution is being increased, beginning in 2002, and will eventually be \$5,000 in 2008 and thereafter. Further, taxpayers age 50 and older are allowed additional "catch-up" contributions of \$500 per year in 2002-2005 and \$1,000 in subsequent years.

With limited exceptions, amounts in a traditional IRA cannot be withdrawn without penalty prior to age 59½. Early withdrawals must be included in gross income and are also subject to an additional 10% penalty tax. The 10% early withdrawal penalty does not apply in cases of death and disability or when the withdrawals are used for qualified higher education expenses or first-time homeowner expenses (up to \$10,000). Amounts withdrawn from an IRA after age 59½ must be included in gross income in the year of the withdrawal. Withdrawals must begin after the individual reaches the age of 70½. Insufficient withdrawals after age 70½ are subject to a penalty tax.

Persons can make nondeductible contributions to their retirement accounts and the earnings on those nondeductible contributions can be excluded from income, as long as the assets are retained within the retirement account.

2. Roth IRA

A Roth IRA is an account for which the contributions are not deductible when made, but qualified distributions, including earnings on contributions, are not taxable. Persons whose adjusted gross income does not exceed \$95,000 if single, \$150,000 if married filing jointly or \$0 if married filing separately may contribute up to \$2,000 per person per year to a Roth IRA. The amount of contribution permitted is phased

out as income rises to \$110,000 for single filers, \$160,000 for married joint filers and \$10,000 for married separate filers.

The increases in contribution limits and the catch-up contributions for taxpayers age 50 and older that apply to traditional IRAs also apply to Roth IRAs.

Distributions from a Roth IRA are not subject to tax if they are made no earlier than five years after the account is established and if the taxpayer has reached age 59½. Earlier distributions are not subject to tax if they are made because of the death or disability of the taxpayer or for first-time homebuyer expenses (up to \$10,000). Nonqualified distributions must be included in gross income and are subject to a 10% penalty tax. Unlike a traditional IRA, distributions from a Roth IRA are not required upon reaching the age of 70½.

3. Education IRA

An education IRA is similar to a Roth IRA: contributions are not deductible, but qualified distributions are not subject to tax if they are used to pay the post-secondary expenditures of the beneficiary.

For tax year 2001, contributions of up to \$500 per child may be made to an education IRA when income is less than \$95,000 for single persons and \$150,000 for married couples filing jointly. The amount that may be deducted is phased out as income rises to \$110,000 for single filers and \$160,000 for married joint filers.

Beginning in 2002, the contribution amount is increased to \$2,000 and the income range at which the contribution is phased out for married couples filing jointly is increased to \$190,000 to \$220,000.

Deduction for Higher Education Expenses

For 2002 and 2003, a deduction of up to \$3,000 will be allowed for higher education expenses when income does not exceed \$65,000 for single persons and \$130,000 for married couples filing jointly. In 2004 and 2005, the maximum deduction will be increased to \$4,000, and a \$2,000 deduction will be allowed for single persons whose income is between \$65,000 and \$80,000 and married couples whose income is between \$130,000 and \$160,000. The deduction is eliminated after 2005.

Wisconsin did not adopt this deduction, since it provides its own tuition deduction. The Wisconsin deduction is described in the "Modifications to Federal Adjusted Gross Income" section.

Student Loan Interest

Persons who have taken out loans on behalf of themselves, their spouse or their dependents to pay for the cost of attending an eligible educational institution may deduct the interest they pay on these loans. The maximum deduction allowed is \$2,500. For 2001, the maximum deduction amount is reduced for single and head of household filers when FAGI is more than \$40,000 and is eliminated when FAGI exceeds \$55,000; for married joint filers the deduction is phased out between \$60,000 and \$75,000 of FAGI. In 2002, these phase-out ranges will be increased to between \$50,000 to \$65,000 for single persons and between \$100,000 and \$130,000 for couples. Married separate filers and those filers claimed as dependents on another's return may not claim the deduction.

Qualified State Tuition Programs

Beginning in 2002, distributions from qualified tuition programs, whether these plans are state-sponsored or offered by private institutions, are exempt from federal tax. Under these programs, contributors purchase tuition credits or certificates on behalf of a designated beneficiary, entitling the beneficiary to a waiver of payment of qualified higher education expenses. Prior to 2002, earnings on these contributions were deferred until distributed and then taxable to the beneficiary, rather than the contributor. Wisconsin already provides an exemption for earnings on these prepaid tuition and college saving plans, described in the "Modifications to Federal Adjusted Gross Income" section.

Self-Employment Tax

Self-employed persons are allowed to deduct one-half of their self-employment taxes, which are paid for social security and Medicare coverage. This deduction equalizes treatment between self-employed and employed persons. For the employed, the social security tax is shared equally by the employer and the employee; the amount paid by the employer is not considered income to the employee and is deductible for the employer.

Health Insurance of Self-Employed Persons

Under federal law, self-employed persons can deduct up to 60% of premiums paid for health insurance. That percentage rises to 70% in 2002 and 100% for tax years after 2002. The deduction may not exceed the earned income from the trade or business for which the insurance plan was established.

Wisconsin allows self-employed persons to deduct 100% of their premiums paid for health insurance, and this deduction is discussed in the section on "Modifications to Federal Adjusted Gross Income". The table shows separately the fiscal effects of the federal 60% deduction and the additional deduction for Wisconsin.

Medical Savings Accounts

The federal deduction allowed for contributions to an Archer Medical Savings Account (MSA) by participants in the MSA pilot program is also allowed for Wisconsin tax filers. Participation in an MSA is limited to the self-employed or to persons employed by firms with 50 or fewer employees. Participation also requires concurrent enrollment in a high deductible health plan, defined as a health plan with a higher annual deductible than typical health plans and with a maximum limit on the annual amount of out-of-pocket medical expenses that the participant must pay for covered expenses. For 2001, the limits for annual deductibles range from \$1,600 to \$2,400 for individual coverage and from \$3,200 to \$4,800 for family coverage; out-of-pocket expenses are limited to \$3,200 for individuals and \$5,850 for families. These amounts are adjusted for inflation each year.

Under the MSA pilot, employer's contributions are excluded from gross income and contributions by individuals are deductible from income. Contributions are limited to 65% of the health insurance deductible for individual plans and 75% of the deductible for family coverage. Distributions from an MSA are excluded from income if used to pay qualified medical expenses, including unreimbursed medical costs of an eligible MSA participant, and his or her spouse or dependents. MSA distributions may not be used to purchase insurance, except for COBRA-type continuation coverage or long-term health insurance. Distributions used for nonqualified expenses are subject to a 15% penalty, unless the participant is disabled or is age 65 or older.

The pilot project was originally scheduled to end December 31, 2000, but now has been extended to December 31, 2002. At that time, existing accounts can be maintained, but new accounts cannot be established without Congressional approval to expand the program.

Moving Expenses

A deduction from gross income is allowed for moving expenses when the move is related to starting work in a new location. Deductible moving expenses include the cost of transporting household goods and personal effects, and the cost of travel to the new residence, including lodging, but not meals.

Alimony

Alimony, separate maintenance or similar periodic payments may be deducted from the gross income of the spouse or former spouse making the payments; however, they are deductible only to the extent that the payments are includible in the gross income of the recipient. Such payments must be made pursuant to a decree of divorce or separation. Child support and property settlements are not considered alimony.

Penalty on Early Withdrawal of Savings

Penalties paid because of premature withdrawal of funds from time savings accounts or deposits may be deducted from gross income. The adjustment is allowed for amounts forfeited to a bank, mutual savings bank, savings and loan association, cooperative bank or homestead association as a penalty for premature withdrawal of funds from a time savings account, certificate of deposit or similar class of deposit. The deduction is not allowed when the loss is incurred in a transaction connected with a trade or business.

MODIFICATIONS TO FEDERAL ADJUSTED GROSS INCOME

A modification is an addition to or subtraction from federal adjusted gross income authorized by the Wisconsin Statutes to compute Wisconsin adjusted gross income (also referred to as Wisconsin total income). In this report, with the exception of the capital gains add modification discussed in the previous section on "Adjustments to Gross Income," only subtraction modifications are described, because they constitute tax exemption devices.

Social Security Benefits: Difference in State and Federal Treatment

Wisconsin taxes up to 50% of social security benefits, while up to 85% of those benefits are subject to federal tax. A subtract modification allows taxpayers subject to the higher federal taxation to reduce taxable social security to the amount taxable in Wisconsin. The \$40 million revenue loss for this modification is in addition to the \$147 million revenue loss from the exclusion discussed in the "Exclusions from Gross Income" section; the total fiscal effect of the state's tax treatment of social security is \$187 million.

Interest on U.S. Obligations

All interest and dividend income, less related expenses, received on obligations of the United States, its territories and the District of Columbia may be subtracted from federal adjusted gross income in determining Wisconsin adjusted gross income. The subtraction applies to interest on obligations issued directly by the federal government and obligations issued by independent agencies, which federal law prohibits states from taxing.

The state taxes interest and dividend income, less related expenses, received from obligations issued by independent agencies that are merely guaranteed by the federal government, provided federal law does not prohibit state taxation. These include bonds issued by the Federal National Mortgage Association (Fannie Mae), Government National Mortgage Association (Ginnie Mae) and the Tennessee Valley Authority. The fiscal effect of this exemption is difficult to estimate because a significant portion of these bonds are held indirectly by individuals through mutual funds, partnerships and other investment vehicles.

Capital Gains Deduction

Wisconsin allows taxpayers to exclude from income 60% of the capital gain on assets held more than one year. This exclusion is generally similar to the exclusion allowed under federal law prior to 1987, but repealed in the Tax Reform Act of 1986.

Capital Gains from Qualified Small Business Stock

The state excludes from income 100% of the amount of net capital gains from qualified business stock issued on or after January 1, 1986. To qualify for the exclusion, taxpayers must be issued a certification notice by the business, have not acquired the stock as a gift, and hold the stock for a period of at least five years. The criteria for qualified small businesses are listed under Wisconsin Statutes, section 71.01 (10). In general, only initial public offerings of small Wisconsin businesses qualify for the exclusion.

Gains on Sales of Business Assets to Related Persons

Gains on sales of business assets, including assets used in farming, to persons related to the seller within the third degree of kinship are not subject to tax. These related persons include parents, children, grandparents, grandchildren, brothers and sisters, uncles and aunts, nephews and nieces, and great grandchildren.

Net Long-Term Capital Losses (Pre-1982)

Net long-term capital losses from years prior to 1982 that were not allowed as an adjustment to federal gross income in the year a federal net capital loss deduction was taken may be subtracted from federal adjusted gross income. The subtraction is limited to \$3,000 (\$1,500 for married persons filing separately). The unused portion of pre-1982 net long-term capital losses may be carried forward to future years.

Taxpayers deducting pre-1982 net long-term capital losses are not subject to the \$500 state limit on the net capital loss deduction described in the earlier section on "Adjustments to Gross Income".

Public Pensions

Payments received from the selected retirement systems by persons who were members of or retired from these systems prior to 1964 are exempt from Wisconsin income, to the extent the payments were included in federal income. The Milwaukee Public School Teachers, Milwaukee City Employees, Milwaukee County Employees, Milwaukee County Sheriff, Milwaukee City Police, Milwaukee Fire Fighters and Wisconsin Public School Teachers retirement systems, and the U. S. Civil Service and Military Employee retirement system are covered by this exemption.

Beginning in 2002, all payments from the U. S. military retirement system and all U. S. government pension payments received by retirees of the U. S. Coast Guard, the commissioned corps of the National Oceanic and Atmospheric Administration and the commissioned corps of the public health service will be exempt.

State Legislators' Per Diem Expenses

Amounts received by state legislators as an allowance for expenses incurred while in Madison on legislative business are excluded from Wisconsin adjusted gross income, provided a deduction for travel expenses is not claimed.

Small Business (Subchapter S) Corporation Subtractions

Since 1979, Wisconsin's treatment of Subchapter S corporations has been comparable to their treatment under federal law. A subtraction modification may be allowed to reflect transitional adjustments or differences between the state and federal basis of stock in such corporations.

Distributive Share of Estates and Trusts

The distributive share of income received from an estate or trust must be adjusted to reflect all Wisconsin modifications to federal adjusted gross income. The distributive share is the beneficiary's portion of income that is distributed from the estate or trust. An example is a taxpayer who receives a total of \$1,500 from a trust, \$300 of which is income derived from interest on U. S. securities. Since federal adjusted gross income includes such interest, the taxpayer subtracts this \$300 to arrive at Wisconsin adjusted gross income.

Distributive Share of Partnership Modifications

The distributive share of income received from a partnership must be adjusted to reflect all Wisconsin modifications to federal taxable income. The distributive share is the taxpayer's portion of income from the partnership. An example is a partnership equally distributing \$2,000 in income to two partners, with \$1,000 of the income consisting of interest from U. S. Treasury bills. For federal purposes, each partner receives \$1,000 in taxable income. However, Wisconsin does not tax interest on U. S. Government securities, so each partner subtracts \$500 from federal income to arrive at Wisconsin adjusted gross income. This \$500 is the distributive share of the partnership modifications.

Wisconsin Net Operating Loss Carryover

A net operating loss (NOL) is generally an excess of allowable business deductions over the gross income realized from operations. In determining whether a net operating loss exists, casualty losses are treated as business losses and salary or wages are treated as business income.

In Wisconsin, net operating losses may be carried forward up to fifteen years to offset income, and thus reduce tax liability. Federal law allows taxpayers to carry losses back three years or forward fifteen in determining taxable income of those years. This difference in federal and Wisconsin carryover periods and other differences in federal and state law may necessitate modifications to federal adjusted gross income to ensure that only Wisconsin business losses are carried forward for state tax purposes. For instance, state and local bond interest and federal NOL carrybacks may be added back to determine the deductible amount of the loss carried forward for Wisconsin purposes.

Health Insurance Premiums of the Self-Employed and Certain Employees: Difference in State and Federal Treatment

Wisconsin allows the self-employed to deduct 100% of their premiums for health insurance for themselves, their spouses and dependents. Employees whose employer does not contribute towards the cost of their health insurance premiums may deduct 50% of their payments for health insurance. The deduction for the self-employed is limited to earned income derived from the trade or business for which the insurance plan was established. Persons eligible to participate in a health insurance plan sponsored by their own or their spouse's employer may not take the deduction. For employees, the deduction is limited to wages. Amounts deducted may not be claimed as medical expenses for purposes of calculating the itemized deductions credit. In addition, the Wisconsin deduction for the self-employed is reduced by the federal deduction allowed for the self-employed (60% of their premiums in tax year 2001). This federal deduction is described in the "Adjustments to Gross Income" section.

The \$6.6 million revenue loss for this deduction is the amount of loss that occurs because the Wisconsin deduction for self-employed is greater than the federal deduction for the self-employed, plus the Wisconsin deduction for employees whose employer does not contribute to their insurance coverage. The revenue loss to the state from the federal deduction for the self-employed is \$8.8 million, so the total fiscal effect of state health insurance deductions is \$15.4 million.

Long-Term Care Insurance Expenses

A deduction is allowed for premiums paid for long-term care insurance. This insurance provides coverage for convalescent or custodial care, or care for a chronic condition or terminal illness that is provided in a person's home, an institution or a community-based setting. Qualified expenses include expenses for policies that cover a taxpayer and his or her spouse. Qualified expenses subtracted from gross income in the calculation of federal adjusted gross income cannot be claimed for this deduction. Also, qualified expenses claimed for this deduction cannot be used to calculate the Wisconsin itemized deduction credit.

Constant Basis Assets

A taxpayer who sold or otherwise disposed of a constant basis asset that has a federal basis different from the Wisconsin basis is required to adjust Wisconsin income to reflect the amount of this difference. This provision applies if the asset was owned prior to January 1, 1965. A constant basis asset is one for which depreciation is not allowed, such as unimproved land.

Adjusted Basis of Assets Acquired after January 1, 1965

A taxpayer who acquires a constant basis asset, such as unimproved land, which has a federal basis different from the Wisconsin basis, is required to modify Wisconsin income to reflect the difference in the year that the asset is sold or otherwise disposed of. When a taxpayer acquires a changing basis asset, one for which depreciation is allowed, such as a building, Wisconsin income is modified to reflect differences in the state and federal bases each year, except that the differences may be amortized over a period of five years or less.

This section applies to property acquired after January 1, 1965, for Wisconsin tax purposes. It also generally applies to taxpayers who move into the state and bring certain property with them.

Unemployment Compensation

Wisconsin excludes from income a portion of unemployment compensation when income falls below certain amounts. Taxable unemployment compensation equals the lesser of total unemployment compensation or 50% of the amount, if any, by which unemployment benefits plus the recipient's adjusted gross income (excluding unemployment compensation and certain disability benefits) exceed specified base amounts. The base amounts are: \$12,000 for single persons and married persons who file separately and lived apart from their spouses for the full tax year; \$18,000 for married persons filing a joint return; and \$0 for married persons who file separately but lived with their spouses for at least part of the tax year. This treatment is similar to pre-1987 federal treatment. The Tax Reform Act of 1986 made all unemployment benefits taxable for federal purposes, beginning with the 1987 tax year.

Disability Income

A subtraction is allowed for payments to disabled persons that are included in federal income but were excluded under Section 105 (d) of the Internal Revenue Code prior to its repeal in 1983.

Adoption Expenses

Adoptive parents may deduct adoption fees, court costs, or legal fees relating to the legal adoption of a child. This subtraction from federal adjusted gross income is limited to \$5,000 of adoption expenses that occur during the tax year in which the adoption is finalized and the two prior tax years. Employer-paid adoption expenses that under federal law are excluded from gross income may not be used for the deduction.

Higher Education Tuition Expenses

A deduction of up to \$3,000 per student per year is allowed for tuition that is paid to any university, college, technical college or a school approved by the Educational Approval Board that is located in Wisconsin. Tuition paid to a public vocational school or public institution of higher education in Minnesota under the Minnesota-Wisconsin reciprocity agreement also qualifies for the deduction. Eligible expenses include tuition for the education of the claimant, the claimant's spouse, and his or her dependent. The maximum deduction amount is reduced for single and head of household filers when FAGI is more than \$50,000, and the deduction is eliminated when FAGI exceeds \$60,000. For married joint filers the deduction is phased out between \$80,000 and \$100,000 of FAGI, and for married separate filers the deduction is phased out between \$40,000 and \$50,000 FAGI.

Prepaid Tuition and College Savings Plans

A deduction of up to \$3,000 deduction per year is allowed for contributions to a college savings plan or to an existing prepaid tuition plan operated by EdVest. To prevent double-counting of the deduction, no deduction is allowed for any costs paid out using distributions from such a college savings or prepaid tuition plan. In particular, taxpayers cannot claim a deduction for tuition financed by a distribution from an EdVest account when the contribution that account was previously deducted.

In addition, any interest earnings on contributions to an EdVest plan may be deducted, to the extent these earnings are included in federal adjusted gross income and provided that the distributions from the plan are used for qualified educational purposes. Beginning in tax year 2002, distributions from these plans will be exempt from federal tax.

The prepaid tuition program is limited to University of Wisconsin System schools. The college savings plan allows individuals to purchase tuition units that apply toward tuition or other costs at any institution of higher education in the United States.

Viatical Settlement Contracts

A viatical settlement is a payment to the holder of a life insurance policy, or to the certificate holder of a group life insurance certificate, which insures the life of a person who has a catastrophic or life-threatening illness or condition. The payment is less than the expected death benefit of the policy or certificate to the person making the payment. Income received under such a viatical settlement contract is exempt from the income tax.

Payments to Victims of Nazi Persecution

Settlements or other payments of claims for assets stolen, hidden or lost by a person due to persecution by Nazi Germany or any Axis regime from 1933 to 1945 may be subtracted in the determination of Wisconsin adjusted gross income to the extent this income is included in federal income. Nonstatutory provisions of the federal Economic Growth and Tax Relief Reconciliation Act of 2001 indicated that such payments were not included in federal gross income. As a result, this subtraction has no fiscal effect.

DEDUCTIONS AND EXEMPTIONS FROM ADJUSTED GROSS INCOME

A deduction is an amount subtracted from Wisconsin adjusted gross income (or total income) to yield Wisconsin taxable income—the amount to which the tax rates are applied. Federal taxpayers may claim either a standard deduction or an itemized deduction, but Wisconsin taxpayers are allowed a standard deduction only. Wisconsin disallowed itemized deductions beginning in 1986, and replaced them with the itemized deductions credit, explained in the next section. Wisconsin also provides a personal exemption that is subtracted from Wisconsin adjusted gross income.

Standard Deduction

Wisconsin provides a sliding scale standard deduction that decreases as income increases. For tax year 2001, the standard deduction for single persons was \$7,440 when Wisconsin adjusted gross income (WAGI) was less than \$10,730, and it was phased out as WAGI rose from \$10,730 to \$72,730. For heads of households, mostly single parents, the deduction was \$9,620 when WAGI was less than \$10,730, and it was phased down to the level of the standard deduction of single filers as WAGI rose from \$10,730 to \$31,460. When WAGI exceeded \$31,460, heads of households received the same deduction as single filers. For joint filers, the standard deduction was \$13,410 when WAGI was less than \$15,070 and was phased out when WAGI was between \$15,070 and \$82,872. For married persons filing separately, the standard deduction was \$6,370 when WAGI was less than \$7,160 and was phased out when WAGI was between \$7,160 and \$39,367. These amounts are indexed for inflation.

The estimate of revenue loss for the standard deduction does not reflect the amount of the itemized deductions credit that would be claimed by persons not currently claiming it if the standard deduction was eliminated; the credit cannot be calculated because the amount of their itemized deductions are not known.

Personal Exemption and Additional Elderly Exemption

Wisconsin provides an exemption equal to \$700 for each tax filer, spouse and dependent, plus an additional exemption of \$250 for each taxpayer and spouse age 65 and older.

CREDITS

A credit is an amount that is subtracted directly from the taxpayer's Wisconsin gross tax liability (i.e., the amount determined by applying the Wisconsin tax rates to Wisconsin taxable income) to determine the Wisconsin net tax liability.

Itemized Deductions Credit

Federal law allows taxpayers a subtraction from federal adjusted gross income for itemized deductions when they exceed the federal standard deduction. Wisconsin does not allow itemized deductions, but has instead a credit for some of the expenses for which federal itemized deductions may be claimed. This credit is equal to 5% of the eligible itemized deductions in excess of Wisconsin's sliding scale standard deduction. The eligible expenses include medical expenses, interest and charitable contributions. No state credit is allowed for the federal itemized deductions for state and local taxes, casualty and theft losses, and miscellaneous expenses.

The expenses used in calculating the Wisconsin itemized deductions credit are described below, and their fiscal effects are estimated. The sum of these estimates for each particular expense exceeds the total fiscal effect for the itemized deductions credit because of interaction effects.

1. Medical Expenses

Most health expenses can be claimed as an itemized deduction to the extent that the total amount of medical expenses not compensated for by insurance exceeds 7.5% of the taxpayer's federal adjusted gross income. Eligible expenses include: fees for doctors, dentists, health practitioners and hospital services; amounts expended for prescription medicine and drugs; premiums paid on medical or health insurance policies; costs of medical equipment (e.g. motorized wheelchairs, hearing aids, dentures, eye glasses); and

the cost of transportation, meals and lodging for needed medical care. The credit for medical expenses reduced tax revenues by \$19 million in FY02.

2. Interest

Under federal law, interest paid on a mortgage secured by real property used by the taxpayer as a qualified personal residence can be claimed as an itemized deduction, subject to certain limits. A qualified residence includes a primary personal residence and one other personal residence. No deduction is allowed for the portion of acquisition indebtedness that exceeds \$1,000,000 (\$500,000 for married persons filing separately) or the portion of home equity indebtedness that exceeds \$100,000 (\$50,000 for married persons filing separately). For the state credit, the residence must be the taxpayer's primary personal residence and it must be located in Wisconsin.

Under federal law, interest paid on indebtedness related to investments can be claimed as an itemized deduction to the extent that the investment interest is offset by the taxpayer's net investment income. Investment interest not allowed as a deduction in the current year can be carried forward indefinitely and claimed as an itemized deduction in future years. Wisconsin allows its credit only for interest paid to purchase or hold securities on which the interest, dividend, gain or other return is subject to Wisconsin tax. The revenue loss from the credit for interest expense was \$201 million in FY02.

Interest paid on indebtedness related to business, rental and royalty property is subtracted separately in determining the net income from the business, rental or royalty activity; see the section on "Deductions Which Further Define Net Income."

3. Charitable Contributions

Contributions to recognized charitable organizations or activities can be claimed as an itemized deduction. In general, a recognized charity is any governmental body or any public or private corporation, trust or foundation organized and operated principally for charitable, religious, scientific, literary or educational purposes. Certain limitations apply on contributions of property or the taxpayer's personal services. Additional limitations apply on the total amount of charitable contributions that can be deducted within a single year. The revenue loss from the credit for charitable contributions was \$82 million in FY02.

School Property Tax Credit

The school property tax credit is equal to 12% of the first \$2,500 of property taxes or rent constituting property taxes paid on a person's primary residence and contiguous land, up to a maximum credit of \$300. For renters, "rent constituting property taxes" means 25% of rent if heat is not included, or 20% of rent if heat is included in rent. No credit is allowed for property taxes or rent that is deductible as a trade or business expense.

Working Families Credit

The working families credit equals a taxpayer's net tax liability, defined as gross tax less the itemized deductions, school property tax and historic rehabilitation credits when income is less than \$18,000 for married couples filing jointly and \$9,000 for other tax filers. Essentially, the credit eliminates tax liability when income is below these ceilings. The credit is phased out over the next \$1,000 of income above these ceilings. The credit is limited to full-year residents, and no credit is allowed for persons who are claimed as a dependent on another filer's tax return.

Married Couple Credit

Wisconsin provides a credit for married couples when both spouses are working to offset the marriage tax penalty facing two-earner couples. A penalty occurs when a married couple pays more tax than what they would if the two spouses were taxed as two single filers. The credit equals 3% of the first \$16,000 of earnings, resulting in a maximum credit of \$480.

Armed Forces Member Credit

Wisconsin allows a nonrefundable credit of up to \$200 for military pay received for service while stationed outside the United States. If both spouses of a married couple filing jointly receive pay for military service outside the country, each may claim the \$200 credit. The credit is allowed for full-year residents of Wisconsin only.

Credit for Sales Tax on Fuel and Electricity Used in Manufacturing

Owners of noncorporate businesses, such as sole proprietorships, partnerships and limited liability companies treated as partnerships, may claim a nonrefundable credit for the amount of sales tax paid on fuel and electricity consumed in manufacturing tangible personal property in the state. Unused credits may be carried forward and offset against tax liability over the next 15 years. This tax is described more fully in the "Corporate Income and Franchise Tax" chapter.

Development Zone Credit

A development zone credit is available to taxpayers who are certified by the Department of Commerce to participate in the Wisconsin development zone program. Credits awarded to noncorporate entities are passed through to their owners in proportion to their ownership interest in the entity, and may be claimed on the owner's individual income tax return. The credit is nonrefundable, that is, limited to tax liability otherwise due. However, unused amounts may be carried forward. This program and the credit is more fully discussed in the chapter on "Corporate Income and Franchise Taxes," since corporations are the prime beneficiaries of the program.

Campaign Fund Tax Credit

Beginning in tax year 2002, taxpayers will be allowed a credit equal to the amount of designations made on their tax return to the Wisconsin election campaign fund. The designation, allowed only to full-year residents, is up to \$20 for each taxpayer and spouse, but not more than tax liability prior to the designation. Because it was not yet in effect, this credit had no fiscal impact in FY02.

Historic Preservation Credits

Two nonrefundable credits are provided to encourage the rehabilitation of historic buildings in Wisconsin.

1. Supplement to the Federal Historic Rehabilitation Credit

The supplement to the federal historic rehabilitation credit, equal to 5% of qualified rehabilitation expenditures, may be claimed for projects eligible for the federal credit. Qualified rehabilitation expenditures, defined under section 48 (g) of the Internal Revenue Code, are expenditures to substantially rehabilitate certified historic buildings for use in a trade or business. The rehabilitation work must meet historic preservation standards and the expenditures must exceed the taxpayer's adjusted basis in the building. Unused amounts of the credit may be carried forward for up to 15 years. The credit applies only to property located in Wisconsin. Taxpayers must reduce their Wisconsin adjusted basis in the building by the amount of the credit claimed. The reduced basis will result in lower depreciation deductions.

For rehabilitation projects undertaken by a partnership, tax-option corporation or limited liability company (LLC), the credit is passed through to the individual partners, shareholders or members in proportion to their ownership interest in the partnership, corporation or LLC.

2. State Historic Rehabilitation Credit

The state historic rehabilitation credit is equal to 25% of qualified expenditures to substantially rehabilitate certified historic buildings for noncommercial use. The credit applies to owner-occupied personal residences, provided that the residence is not used in the course of a trade or business. The credit cannot be claimed for rehabilitation of a personal residence if the person has already claimed a rehabilitation credit for another personal residence within the preceding five years. The rehabilitation work must meet historic preservation standards and the expenditures must exceed \$10,000. The maximum credit amount is \$10,000 (\$5,000 for married persons filing separately). Unused amounts of credit can be carried forward for up to 15 years. The credit applies only to property located in Wisconsin.

Taxpayers must reduce their Wisconsin adjusted basis in the building (or entire property, if not a building) by the amount of the credit claimed. The reduced basis will have the result that taxpayers may have an increased taxable gain from the sale or exchange of the property.

Earned Income Credit

Wisconsin allows low-income workers with dependents to claim a Wisconsin earned income credit equal to a percentage of the federal earned income tax credit, depending on family size. The credit is refundable; any amount of the credit in excess of taxes otherwise due is rebated to the taxpayer.

The Wisconsin credit is 4% of the federal credit for persons with one child, 14% for persons with two children and 43% for persons with three or more children. For persons with one child the 2001 federal credit was 34% of the first \$7,140 of earnings, and for persons with two or more children the credit was 40% of the first \$10,020 of earnings. These federal credits were phased out as the greater of earnings or federal adjusted gross income rose from \$13,090 to \$28,281 for persons with one child and from \$13,090 to \$32,121 for persons with two or more children. The maximum credit and the range over which the credit is phased out are indexed to inflation. In addition, the phase-out floor and ceiling for couples will be increased by \$1,000 in tax years 2002 through 2004, by \$2,000 in tax years 2005 through 2007, and by \$3,000 for tax years after 2007.

Federal law also allows a credit for low-income workers without children; Wisconsin has no similar credit.

Homestead Credit

Low-income homeowners and renters may qualify for an income tax credit or refund based on household income and property taxes or rent constituting property taxes. To qualify, the person:

1. Must be 18 years of age or older by the last day of the calendar year;
2. Must not be claimed as a dependent on anyone else's federal income tax return (unless the claimant is 62 years of age or older).
3. Must be a legal resident of Wisconsin for the entire calendar year.
4. Must have household income (of the claimant and spouse) of less than \$24,500.

In addition, persons are ineligible for the credit if they:

1. Live in a nursing home and receive medical assistance (Title XIX) at the time of filing the claim;
2. Live the entire year in housing that is exempt from property taxes;
3. Claim the farmland preservation credit for their home; or
4. Receive general relief payments of \$400 or more for each month of the year of claim, or public assistance (Aid to Families with Dependent Children or Temporary Assistance for Needy Families) for the entire year of claim.

For renters, property taxes are assumed to be 20% of rent if heat is included or 25% of rent if heat is not included in the rent. In computing household income, a claimant may deduct \$250 for each dependent living with the claimant.

For tax year 2001 claims, the amount of credit was determined as follows:

1. If household income was \$8,000 or less, the credit was 80% of property taxes up to \$1,450; thus, the maximum credit was \$1,160.

2. If household income exceeded \$8,000 but was no more than \$24,500, the credit was 80% of the amount by which property taxes exceeded 8.778% of household income in excess of \$8,000.
3. If household income exceeded \$24,500, no homestead credit was allowed.
4. The minimum credit for claimants with household income less than the \$20,290 ceiling was \$10.

Income Taxes Paid to Other States/Income Tax Reciprocity

If a person lives in one state and is employed in another, income may be subject to taxation in both states. To alleviate this double taxation, the state in which the taxpayer resides may allow a credit for income taxes paid elsewhere. Alternatively, two states may enter into a reciprocity agreement whereby the taxpayer is only required to pay state income taxes to the home state. Currently, Wisconsin has reciprocity agreements with Illinois, Indiana, Kentucky, Michigan and Minnesota.

1. Credit for Taxes Paid to Other States

Wisconsin residents may reduce their Wisconsin income tax by the amount of income taxes paid to other states (or the District of Columbia). The credit is not allowed if wages are earned in states having reciprocity agreements with Wisconsin. The revenue loss from this credit was \$58 million in FY02.

2. Income Tax Reciprocity

Since there are more Wisconsin residents employed in Minnesota and Illinois than residents of those two states working in Wisconsin, the income tax revenue foregone by those two states exceeds the taxes foregone by Wisconsin as a result of reciprocity. Either state could capture these additional revenues by eliminating reciprocity, but that would require individuals living in one state and working in the other to file income tax returns with both states. To avoid this and to eliminate the need for credits for taxes paid to the other state, Wisconsin has agreed to pay both Minnesota and Illinois an amount equal to the tax each state foregoes in excess of the amount of tax Wisconsin foregoes as a result of reciprocity. Payments in FY02 were \$47,899,000 to Minnesota and \$29,401,000 to Illinois.

Beginning with the tax year 2001 payment in FY03, Wisconsin will also pay interest on its payment to Minnesota to compensate for the delayed receipt of tax revenues as a result of reciprocity. Without reciprocity, Minnesota would have received 2001 taxes during that year through withholding, with final payments due April 15, 2002, while the reciprocity payment for 2001 is not made until December 2002.

Claim of Right Credit

A taxpayer who repays income in the current year that had been subject to tax in a previous year may claim a refundable credit for the amount of tax paid on that income in the previous year.

Farmland Tax Relief Credit

A farmland tax relief credit equal to a percentage of property taxes up to \$10,000 on farmland, exclusive of improvements, is provided to owners of farmland. The Department of Revenue sets the credit percentage so that expenditures on the credit for all claimants, individual and corporate, is \$15 million, adjusted for expenditures in excess of or less than this amount in the prior fiscal year. For tax year 2001, the credit rate was 13% and total expenditures, for individual and corporate farmland owners, were \$13.7 million. For 2002, the credit rate will be 30%, a substantial increase over the previous year because of the substantial decline in farmland property taxes resulting from use value assessment of farmland. If the credit rate exceed 15%, the maximum credit is limited to \$1,500.

No credit is allowed for property taxes on farm buildings or other improvements on the farmland. The credit is refundable. To be eligible for the credit, the claimant must be domiciled in the state for the entire year and own the property on which the claim is based. This farmland must be at least 35 acres and be part of a farm that produces gross profits of at least \$6,000 in the year the credit is claimed, or \$18,000 in total for the year the credit is claimed and the two prior years.

Farmland Preservation Credit

The Farmland Preservation Credit program allows owners of Wisconsin farmland to reduce their state income tax liability by a percentage of the property taxes paid on the land. The purpose of the credit is to encourage farmers to keep their land in agricultural use.

To be eligible for the credit, the following conditions must be met:

1. The claimant must be a resident of the state for the entire year for which the credit is claimed and must own the land for which the credit is claimed.
2. The farmland upon which the claim is based must be zoned exclusively for agricultural use or the claimant must have signed a farmland preservation agreement.
3. The farmland on which the claim is based must be at least 35 acres and must produce at least \$6,000 in gross farm receipts in the year for which the credit is claimed, or a total of \$18,000 in gross farm receipts in the year for which the credit is claimed and the two preceding years. If at least 35 acres of the farmland is enrolled in the federal Conservation Reserve Program, the farmland does not have to meet the gross farm receipts test.
4. The claimant or his or her spouse may not claim a homestead credit for the same period as that for which the farmland credit is claimed. In addition, only one member of a household may claim the farmland credit.
5. The claimant must certify that all taxes owed by the claimant on the farmland for the year before the year for which the claim is made have been paid.
6. The claimant must be in compliance with county soil and water conservation standards.

The maximum credit is \$4,200. The following table gives examples of potential credit amounts for selected combinations of income and property tax.

| Household Income | Real Estate Taxes Levied on the Farmland in the Tax Year for Which the Claim Is Based | Potential Credit |
|------------------|---|------------------|
| \$ 5,000 | \$2,000 | \$1,800 |
| 10,000 | 2,000 | 1,485 |
| 15,000 | 4,000 | 2,640 |
| 20,000 | 4,000 | 2,255 |
| 25,000 | 5,000 | 2,360 |
| 30,000 | 6,000 | 2,115 |
| 50,000 | 6,000 | 600 |

The claimant receives 70%, 80%, 95% or 100% of the potential credit shown in the table, depending on whether the claimant has a farmland preservation agreement or participates in the program through zoning, and on the type of action the county and municipality have taken on the agricultural preservation plan or zoning ordinance. The Department of Agriculture, Trade and Consumer Protection can inform claimants of the percentage they can expect to receive.

The amount of any Farmland Preservation Credit received is treated as income for Wisconsin tax purposes and must be reported as such on the claimant's tax return for the year in which it is received.

Under certain circumstances, if a farmland owner removes land from the Farmland Preservation Program, tax credits received on the land, for the preceding 10 years, including interest on the credits, must be repaid.

DEDUCTIONS WHICH FURTHER DEFINE NET INCOME

This report estimates the cost to the state of providing exemptions from the income tax for items that would otherwise be taxable. In earning a trade or business income, certain expenses are necessarily incurred, and individuals are allowed to deduct these expenses in determining the net income from the trade or business subject to tax. These deductions are described below, but their fiscal effect is not estimated because they are not truly exemption devices. Rather, they are used to define net income, upon which the income tax is imposed.

Trade and Business Expenses

A deduction from gross income is allowed for the ordinary and necessary expenses that are directly attributable to a trade or business carried on by the taxpayer. Services by the taxpayer as an employee are not considered a trade or business. Examples of expenditures normally allowed as deductions include: employee compensation and benefits, the cost of operations, fuel and electricity, advertising expenses, interest paid, insurance, legal fees, bad debts, depreciation, amortization, and depletion.

Employee's Trade and Business Expenses

Employees are allowed to deduct from gross income certain trade and business expenses that are incurred in the performance of job-related services for their employers. For purposes of computing adjusted gross income, the deduction is limited to:

1. All costs (including entertainment expenses) incurred in connection with one's job for which reimbursement is received either through an expense allowance or some other means. Amounts constituting reimbursement for employee expenses must be included in gross income in most instances.
2. Travel expenses whether or not reimbursement is received for them. They include the cost of transportation, meals, lodging and the use of certain services, e.g. telephone services.
3. All business expenses of an outside salesperson, defined as an individual who solicits business as a full-time salesperson away from his or her employer's place of business. This deduction would cover items such as insurance, depreciation on an automobile or other vehicle, food, lodging, telephone charges and entertainment.

Federal regulations provide that if an employee receives a reimbursement exactly equal to his expenses and makes a sufficient accounting to the employer, he need not report the reimbursement as gross income, in which case none of the expenses may be deducted in determining adjusted gross income.

Expenses Related to Rent and Royalty Income

The expenses related to rent and royalty income are deductible from gross income. These expenses include taxes, interest, depletion, depreciation and other expenses such as repairs, employee wages, utilities, insurance and losses.

CORPORATE INCOME AND FRANCHISE TAX

Taxation of corporate income was enacted in Wisconsin in 1911, at the same time the individual income tax was created. Since enactment, the basic features of the corporate tax have remained fairly constant, with two noteworthy changes: a shift from graduated rates to a flat rate in 1981 and federalization of the tax base in 1987. In 1981, a series of rates and brackets were replaced with a single flat rate of 7.9%. Under the federalized state corporate tax in effect since 1987, corporate taxpayers are subject to tax on the Wisconsin apportioned share of their federal net taxable income, with a limited number of adjustments for the relatively few remaining federal/state law differences and the ongoing effects of previous law differences.

Corporations are actually subject to one of two state taxes. The corporate *income* tax, imposed since 1911, is a tax on the net income of corporations doing business in the state. The corporate *franchise* tax, imposed since 1965, is a tax on the privilege of doing business in the state. Corporate net income is used as the measure or base for the franchise tax. The distinction between the two taxes is a subtle one, relating primarily to the restrictions under federal law on the types of income that states can tax with an income tax (e.g., interest from U. S. obligations). The vast majority of corporations pay the franchise tax. The income tax applies to corporations whose business in Wisconsin consists entirely of foreign or interstate commerce, and corporations that are filing their final return before dissolution. Because both levies employ the same rate and the same general rules for determining corporate net income (although interest income from US obligations cannot be taxed under the income tax), the two taxes are usually considered as one.

Wisconsin also imposes a recycling surcharge equal to 3% of the gross tax liability of regular (C) corporations and 0.2% of the net income of tax-option (S) corporations and other business entities. The surcharge and its exemptions are treated in a separate chapter.

Corporations that conduct business in more than one state must apportion their net income among the states with jurisdiction to tax the income. Wisconsin, like most states with corporate income or franchise taxes, uses an apportionment formula based on three factors—property, payroll and sales. In the Wisconsin apportionment formula, the sales factor is double-weighted (50%) and the property and payroll factors are single-weighted (25% each).

Wisconsin provides for differential tax treatment of business income depending on the form of organization under which a business or organization operates. The business income of proprietorships and partnerships is reported and taxed on the individual income tax returns filed by the owners of the business. Tax-option or Subchapter S corporations are corporations that have elected under Subchapter S of the Internal Revenue Code to have their business income taxed to the individual owners of the business in essentially the same manner as a partnership.

Businesses that are organized as regular, or Subchapter C, corporations pay the corporate income/franchise tax. In addition, under certain circumstances, the business income of nonprofit organizations and certain types of trusts can be subject to the state corporate tax.

1993 Wisconsin Act 112 authorized the formation of a new form of business organization, the limited liability company (LLC). LLCs combine the limited liability protection afforded to owners of corporations with the flow-through tax benefits provided to owners of S corporations and partners in partnerships. Generally, business income of LLCs is reported and taxed on the individual income tax returns of the owners (called members) of the business. However, some LLCs choose to be taxed as corporations, and their business income is reported as taxed on the corporate return.

Collections

In FY02, corporate tax collections were \$503 million, or 5% of total general purpose revenue (GPR) taxes. Although corporate tax collections continue to be a major source of revenue for the state, they have declined as a share of total state tax revenues. Enactment and expansion of the state sales tax and growth of the individual income tax have reduced the relative importance of the corporate tax as a revenue source.

Data Sources

Tax exemption devices applicable to the corporate income tax are grouped into five categories: exemptions, exclusions, special treatments, deductions and credits. The following data sources were used to estimate the fiscal effects of these exemption devices.

1. Wisconsin Corporate Income Tax Model. Fiscal estimates were based in part on data and analysis provided by a computerized corporate income and franchise tax model. Like the Individual Income Tax Model, the corporate model depends on scientifically selected samples of returns from state taxpayers. The model contains nearly 4,000 1999 corporate returns, weighted to reflect the corporate tax filing population.
2. Wisconsin Corporate Tax Collection Statistics. Department of Revenue annual aggregate statistics of corporate tax collections and data from individual corporate returns were also used to estimate fiscal effects.
3. Wisconsin Econometric Model. The Wisconsin econometric model consists of several hundred statistical equations that together simulate the state economy. The model, used in conjunction with the national forecast and database of Global Insight, Incorporated (formerly Data Resources, Incorporated), provided estimates for a variety of exemption devices.
4. Federal Tax Expenditure Estimates. The Congressional Budget Act of 1974 requires preparation of a federal tax expenditure budget annually. These "expenditures" reflect the cost in lost federal revenues of the wide variety of exemptions and incentives contained in the Internal Revenue Code. Using Congressional Budget Office, Joint Tax Committee and U.S. Department of Treasury figures, estimates of the fiscal effect of comparable provisions contained in state law were generated. The procedure followed was first to apportion the federal tax expenditure to Wisconsin, and then to adjust for the difference in state and federal tax rates.
5. Statistics of Income, *Corporation Income Tax Returns*. Published annually by the Internal Revenue Service, this document provides aggregate data for income and deduction amounts reported on federal returns. By apportioning the appropriate figures to Wisconsin using the 1.2% ratio of Wisconsin income to U.S. income, and applying a marginal rate of 7.9%, fiscal estimates for a number of exemptions were obtained.
6. Annual Reports. Annual company reports served as additional sources of information and also as checks for other data. Among those industries whose reports proved beneficial were railroads, credit unions and insurance companies.
7. Miscellaneous Sources. Federal and state government agencies, which publish data relating to the corporate sector, and experts in specific areas of corporate taxation, such as the treatment of insurance companies, the legal status of the Menomonee Indians and bank liquidations, provided additional information.

Several methodological issues complicate the estimation of the revenue loss associated with corporate tax exemption devices. The major obstacle is the lack of useful data. For several exemptions, for example, cooperatives and nonprofit organizations, data needed to estimate the fiscal effect were not available. When data are available, they often only approximate the exempt income or deductible expenses for which an estimate is being made. Data may be several years old, which reduces its usefulness given the potential volatility in economic conditions across the nation, within the state, or within a particular industrial sector. Interest rates, price levels, industrial reorganizations and many other factors contribute to this volatility. Further, the corporate tax is imposed on corporate profits, which can be highly variable. Finally, the estimation process requires assumptions, for example, on Wisconsin's share of some national aggregate or the profitability of corporations operating in Wisconsin relative to firms nationwide. Frequently there is limited information on which to base these assumptions, so they may introduce errors into calculations.

TABLE 1
CORPORATE INCOME AND FRANCHISE TAX EXEMPTION DEVICES SUMMARY

| Exemption Devices | Statutory Reference* | FY02 Fiscal Effect |
|--|--|---|
| Exemptions from Taxation Governmental Units Nonprofit Corporations or Associations Nonprofit Organizations Private Foundations Cooperatives Credit Unions Insurance Companies Banks Under Liquidation Assets Distributed to the Menomonee Indian Tribe Activities of Out-of-State Publishers and Certain Foreign Corporations | s. 71.26 (1)(b) and (bm) s. 71.26 (a) s. 71.26 (1)(c) and (c) s. 71.26 (1)(a) s. 71.43 (2) and 71.45 (1) s. 71.26 (1)(d) s. 71.26 (1)(e) s. 71.23 (3) | None None \$36,000,000 None \$5,500,000 Not Available Minimal Minimal Not Available |
| Exclusions From Income Life Insurance Proceeds Exchanges of Corporate Property or Stock Like-Kind Exchanges Other Exchanges Debt Cancellation Through Bankruptcy Recovery of Bad Debts, Prior Taxes and Delinquency Amounts Natural Resource-Related Cost-Sharing Payments Foreign Sales Corporations | IRC s. 101 IRC ss. 1031 to 1033 and 1036 to 1038 IRC s. 108; 11 U. S. Code 1079 IRC s. 111 IRC s. 126 IRC s. 921 to 927 | Minimal Not Available Not Available Not Available Minimal Minimal \$10,500,000 |
| Special Treatment Limit on Tax Liability of Insurers Urban Mass Transportation Companies RICs, REITs and REMICs Double Weighting of the Sales Factor "Throwback" Sales Tax-Option Corporations Limited Liability Companies | s. 71.46 (3) s. 71.39 IRC ss. 851 to 860 and 860A to 860G, s. 71.26 (2)(b) s. 71.25 (6) s. 71.25 (9)(b)2m and 3, and (9)(c) IRC ss. 1361 to 1368 and 1374, ss. 71.32 to 71.365 ch. s. 71 and 183 | \$10,000,000 None Minimal \$16,000,000 \$9,200,000 Not Available Unknown |
| Deductions from Gross Income Deductions Which Further Define Net Income Amortization and Other Special Cost Recovery Allowances Circulation Expenditures R&D Expenditures Conservation Expenditures Architectural Barriers Tertiary Injectants Reforestation Expenditures Start-Up Expenditures Intangible Drilling Costs Mine Exploration Other Amortization Charitable Contributions | Various IRC sections IRC ss. 169, 173 to 175, 178, 180, 190, 193 to 195, 263(c), 291, 611, 612, 616 and 617 IRC s. 170 | Not Applicable Minimal \$5,000,000 Not Available Minimal Minimal Minimal \$300,000 Minimal Minimal Not Available \$6,000,000 |

TABLE 1
CORPORATE INCOME AND FRANCHISE TAX EXEMPTION DEVICES SUMMARY (continued)

| Exemption Devices | Statutory Reference* | FY02 Fiscal Effect |
|--|--|---|
| Depreciation—Accelerated and Modified Cost Recovery System Accelerated Depreciation Section 179 Expensing | IRC ss. 167, 168 and 179; s. 71.26(3)(y) | \$90,000,000 \$1,500,000 |
| Dividends Dividends Received Patronage Dividends Depositor's Dividends | IRC ss. 591 and 1382; s. 71.26 (3)(j) | Not Available Not Available Not Available |
| Bad Debt Reserves of Financial Institutions Net Operating Loss Carryforward | IRC ss. 585 and 593 s. 71.26 (4) | \$400,000 \$53,900,000 |
| Credits Credit for Sales Tax on Fuel and Electricity Used in Manufacturing Research Expenditures Credit Research Facilities Credit Supplement to Federal Historic Rehabilitation Credit Development Zone, Development Opportunity Zone, Enterprise Development Zone and Agricultural Zone Credits Technology Zone Credit Farmland Tax Relief Credit Farmland Preservation Credit Investments in the Community Development Finance Company Insurance Security Fund Assessments | ss. 71.07 (3s), 71.28 (3) and 71.47 (3) ss. 71.28 (4) and 71.47 (4) ss. 71.28 (5) and 71.47 (5) ss. 71.28 (6) and 71.47 (6) s. 71.28 (1dx) ss. 71.28 (3g) and 71.47 (3g). ss. 71.28 (2m) and 71.47 (2m) ss. 71.28 (2), 71.47 (2) and 71.57 to 71.61 ss. 71.28 (1) and 71.47 (1) s. 646.51 (7) | \$29,400,000 \$9,100,000 \$800,000 \$350,000 \$1,700,000 None \$470,000 \$310,000 None Minimal |

* References to sections of the 2001 Wisconsin Statutes, except "IRC" indicates a reference to a section of the federal Internal Revenue Code authorizing the exemption device.

EXEMPTIONS FROM TAXATION

An exemption allows certain types of organizations, or certain activities related to those organizations, to be free of Wisconsin corporate franchise or income taxes.

Governmental Units

All political units are exempt from income taxation. This includes the federal and state governments, counties, cities, towns, villages, school districts, technical college districts, and special governmental districts like sewerage treatment districts and family care districts. Also exempt are quasi-governmental districts formed for some special public purpose, including local exposition, professional baseball park, professional football stadium and local cultural arts districts.

Under the provisions of the United States Constitution, states cannot tax the assets or income-generating activities of the federal government. The state does not tax the assets or income-generating activities of local governments. Defining the net income of local government activities would be difficult, since such activities are generally not trades or businesses. In the case of activities that could be considered trades or businesses, such as municipal water utilities or public golf courses, the activities rarely result in net income to the local government.

Nonprofit Corporations or Associations

All religious, scientific, educational, benevolent or other corporations or associations not organized or operated for profit are exempt from income taxation on income from activities related to their tax-exempt purpose. Examples

include college alumni groups, scouting organizations, religious and other not-for-profit nursing homes, community-based fund-raising drives for the needy, public interest research groups, and foundations.

Nonprofit organizations with income from business activities that are not related to their tax-exempt purpose are subject to a corporate-level unrelated business income tax (UBIT) similar to the federal UBIT. Certain types of income, such as royalties, are not included in UBIT.

Nonprofit organizations are not subject to tax on income from contributions and business activities related to their tax-exempt purpose because this income is used to provide the public services for which these organizations exist. The fiscal effect from this exemption is shown to be zero because if nonprofits were subject to tax, they would have little or no income subject to tax.

Private foundations are treated differently since their activities tend to be more restricted than tax-exempt nonprofit organizations. Foundations generally do not conduct activities; rather, they provide grants to other organizations to conduct the activities. Thus, the investment income of foundations greatly exceeds their low amount of operating costs. Since 1969, the federal government has imposed an annual excise tax on the net investment income of private foundations and a series of penalty levies linked to the failure of foundations to meet certain specified operating requirements. The state does not impose a similar annual excise tax on private foundations.

Cooperatives

Cooperatives organized under Chapter 185 of the Wisconsin Statutes are exempt from income taxation, provided they operate without profit to any shareholder or member and distribute their proceeds according to the procedures set out in section 185.45, Wis. Stats. Cooperatives may be organized for any lawful purpose except banking or insurance.

Agricultural cooperatives engaged in marketing farm products for producers, and associations or corporations that process and market farm products for such cooperatives, are exempt from income taxation. To retain their exemption status, cooperatives must: 1) have at least twenty-five members, 2) return to producers the net proceeds resulting from sale of their products, and 3) in the preceding five years have limited payments of members' dividends to no more than 8% per year. Corporations processing and marketing farm products for agricultural co-ops are additionally required to deal solely in farm products, and cannot charge more than a sufficient amount to cover the costs of: 1) marketing and processing, 2) payment of dividends not to exceed 8% per year, and 3) a 5% addition to surplus.

Because cooperatives, by definition, do not operate for profit, they would not have a taxable net income if subject to tax. Thus, the exemption has no fiscal effect. Distributions made by cooperatives to the cooperative members may be taxable, depending on the nature of the distribution (see the discussion of patronage dividends under the section on "Deductions from Gross Income").

Credit Unions

Federally-chartered credit unions are exempt from state taxation under federal law. Wisconsin exempts state-chartered credit unions from taxation, except for the portion of their net income attributable to public deposits from the state or local governments. There are approximately 330 credit unions operating in Wisconsin; most of them are state chartered.

The estimate does not take into account the fact that, if credit unions did lose their exempt status, they would most likely receive much of the same favorable tax treatment accorded other financial institutions.

Insurance Companies

The following insurance companies are exempt from income taxation:

- Insurance companies exempted under section 501 (c)(15) of the Internal Revenue Code. This section exempts companies other than life insurance companies whose net written premiums (or, if higher, their direct written premiums) do not exceed \$350,000.
- Town mutual companies organized under Chapter 612 of the Wisconsin Statutes.
- Foreign insurance companies, that is, any insurance company organized outside the state of Wisconsin.
- Domestic life insurance companies engaged exclusively in life insurance.
- Domestic insurance companies insuring against losses relating to mortgages.

In general, only domestic insurers pay the corporate franchise tax to the Department of Revenue, based on the portion of their net income attributable to lines of insurance other than life insurance. There are between 100 to 150 insurance companies subject to the franchise tax. Other insurance companies pay a premium tax (\$96 million in collections in FY02) to the Office of the Commissioner of Insurance, based on the amount of premiums written in Wisconsin. According to the annual report of the Office of the Commissioner of Insurance, there are nearly 1,600 insurance companies with operations in the state, of which about 250 are domestic companies. Of the domestic companies, about 70 are town mutual companies. The fiscal effect of this exemption is unknown since it is not clear how income subject to tax would be defined.

Banks Under Liquidation

Banks placed in the hands of the Division of Banking, Wisconsin Department of Financial Institutions, for liquidation under section 220.08, Wis. Stats., are exempt from tax if such taxation would diminish the financial assets needed to make full payment to depositors. There have been relatively few bank liquidations in Wisconsin since the Depression in the 1930s. It is unlikely that this pattern will change. If it did, very little tax revenue could be expected from financial institutions undergoing liquidation.

Assets Distributed to the Menominee Indian Tribe

Assets distributed by the U.S. Government to members of the Menominee Indian Tribe or any corporations or organizations created by the tribe are exempt from state taxation. In addition, stocks, bonds and other securities issued by tribal corporations or organizations are exempt from state tax.

Under federal law, states generally do not have the authority to tax business activities of Indian tribes provided that the activities are conducted on reservation property or property held in tribal trust.

Activities of Out-of-State Publishers and Certain Foreign Corporations

Under federal law, a state has jurisdiction to tax the Wisconsin-apportioned share of the net income of an out-of-state corporation only if the corporation has nexus—that is, a business presence—in Wisconsin. A corporation generally has nexus in Wisconsin if it has property or employees (i.e., payroll) in the state on a regular basis. Certain exceptions to the nexus rules exist so that some out-of-state corporations will not be subject to the Wisconsin income and franchise tax.

Wisconsin allows the following exemptions from nexus:

- The storage of property with a firm in this state for purposes of fabricating, processing, manufacturing or printing the property for an out-of-state corporation.
- The storage of property on the premises of a Wisconsin firm when the intent is to distribute the goods outside the state.
- The printing, storage and distribution of books, magazines and other publications for out-of-state publishing companies that contract with Wisconsin printing firms.
- The storage of property in Wisconsin for no more than 90 days by foreign corporations, provided the property is stored at a site not owned by the foreign corporation and is transferred and used in the state for fabricating,

processing, manufacturing or printing on the site where the property is stored. Further, the assessed property value of the site where the property is stored and transferred must be at least \$10 million but not more than \$11 million on January 1, 1999.

The out-of-state corporations usually have no payroll or plant and equipment in Wisconsin. Thus, the act of storing property in the state for processing, printing or other temporary purposes would have been the only factor establishing nexus, and in turn, a Wisconsin tax liability for the corporations, in the absence of these exemptions.

EXCLUSIONS FROM INCOME

An exclusion is an item that is not included in the definition of gross income. Excluded income normally does not have to be reported on the tax return.

Life Insurance Proceeds

Amounts received by a corporation from an insurance company or any other insurer as payment for a death claim are exempt from income taxation. For example, if a company took out policies on the lives of its board members and was paid the value of insurance on the life of one of the board members upon his or her death, the insurance benefit would not be included in the income of the corporation subject to tax. However, the company could not claim a business expense deduction for the premiums it paid on the policy.

Companies are believed to represent a small proportion of all beneficiaries. Further, because insurance compensation is usually paid on the deaths of individuals past retirement age, the effect of this provision is thought to be small.

Exchanges of Corporate Property or Stock

In general, gain will be recognized as a result of an exchange or disposition of property to the extent that any cash proceeds, plus the taxpayer's basis in new property, exceeds the taxpayer's basis in the old property. However, gains from the following types of transactions are excluded from gross income:

- Exchange of property held for productive use in a trade or business or held for investment for like-kind (i.e., similar) property. Examples of like-kind exchanges are an exchange of a delivery truck for a delivery van, and an exchange of one real property for another real property. The nonrecognition of gain does not apply to exchanges involving inventory and intangible investments, such as stocks and bonds, or to any exchanged property disposed of within two years by either party, with exceptions for death or involuntary conversions.
- Exchange of stock in the corporation for property. For example, a shareholder might contribute property to a corporation for additional shares of stock.
- Involuntary conversions. There is no recognition of gain from involuntary conversions of property provided that the property is converted into similar property, or if it is converted into money used to acquire similar property.
- Exchange of common or preferred stock in a corporation for similar stock in the same corporation. For example, a shareholder might be allowed to convert 100 shares of old stock into 200 shares of new stock.
- Certain exchanges of United States obligations. There is generally no recognition of gain if United States obligations must be surrendered in exchange solely for other United States obligations.
- Certain reacquisitions of real property. There is generally no recognition of gain if the seller of real property reacquires a real property in exchange for satisfaction of indebtedness secured by the real property.

The fiscal effects of these exemption devices are generally small because they represent a postponement of income that will eventually be taxed. In general, the taxpayer's basis in the new property is equal to the basis in

the old property, or otherwise reduced to take into account the fact that the property was acquired in a tax-free transaction.

Debt Cancellation Through Bankruptcy

When debt is forgiven in connection with a bankruptcy proceeding, the income realized is not subject to tax unless the principal purpose of the bankruptcy plan is to evade income taxes.

No information is available on which to estimate the fiscal effect of this exemption device.

Recovery of Bad Debts, Prior Taxes and Delinquency Amounts

Receipts generated by the recovery of bad debts, prior taxes or delinquency amounts are excluded from gross income to the extent that they did not reduce income tax liability when deducted in a prior year. The portion of a recovery amount that gave rise to a tax benefit in prior years is taxable.

Natural Resource-Related Cost-Sharing Payments

Payments received by corporations primarily for the purpose of conserving soil and water resources, protecting or preserving the environment, improving forests, or providing a habitat for wildlife may be excluded from gross income.

Foreign Sales Corporations

Until 2000, federal law exempted a portion of the foreign trade income of a foreign sales corporation (FSC) from federal tax, provided that the income was derived from the foreign presence and business activity of the FSC. Following a ruling by the World Trade Organization (WTO) that the FSC provides an unfair trade advantage to these companies, the FSC exemption was repealed and replaced with an extraterritorial income exclusion. Wisconsin did not adopt the federal FSC repeal and enactment of Extraterritorial Income Exclusion Act of 2000, which provided the new scheme to address WTO concerns. As a result, companies meeting the requirements of the former federal FSC exemption may still exclude income from tax in Wisconsin.

The special tax treatment of the FSC is designed to stimulate export sales by domestic firms. The FSC must be a separately incorporated exporting entity, recognized under the laws of a foreign country or United States possession, and must maintain an office outside the United States. Distributions from the FSC to the parent corporation are generally eligible for the dividends-received deduction for dividends from controlled subsidiaries (see the discussion of dividends under the section on "Deductions from Gross Income").

SPECIAL TREATMENT

Certain corporate entities are subject to tax provisions that are substantially different from those provided for most corporations. While these entities pay corporate franchise or income taxes, the method used to compute the tax liability is different from that afforded other corporate taxpayers.

Limit on Tax Liability of Insurers

The tax liability of insurance companies subject to the state income/franchise tax (see the discussion under the section on "Exemptions") is limited to 2% of the gross premiums derived from non-life lines on insurance in Wisconsin.

Urban Mass Transportation Companies

Any corporation deriving 50% or more of its gross income from urban mass transportation is assessed a special tax of one-half of taxable income. Before the imposition of this tax, an amount equivalent to 8% of the depreciated cost of property used or useful in business, as well as federal income tax payments, are deductible; interest paid is not. No revenue has been collected under this special tax levy since 1974.

There are approximately 23 county or municipality-owned urban mass transportation companies in Wisconsin, with the vast majority of revenues coming from operations in Milwaukee, Madison, Racine, Eau Claire and Green Bay. Because each of these companies generally registers losses or no net income, this exemption has no fiscal effect.

RICs, REITs and REMICs

Certain types of corporations are substantially or fully exempt from tax at the corporate level provided that they meet certain percentage requirements for distributions to shareholders. These corporations are generally organized as investment vehicles and do not carry on a trade or business other than the investment activities.

A regulated investment company (RIC) must derive its income primarily from interest, dividends and gains from the disposition of stock and securities. Most mutual funds are organized as RICs. At least 90% of a RIC's income must be distributed to its shareholders each year. If so, the corporation is allowed a deduction for the distributions to shareholders. This deduction reduces the corporation's net taxable income to a minimal amount and effectively eliminates any corporate tax liability. Failure to meet the distribution requirements results in the denial of the deduction and a substantial corporate tax liability.

A real estate investment trust (REIT) specializes in real estate investments and must derive its income primarily from rents from real property, other real property income, interest, dividends and gains from the disposition of stock and securities. At least 90% of a REIT's income must be distributed to its shareholders each year. The taxation of REITs is essentially the same as the taxation of RICs in that a deduction for distributions to shareholders is allowed if the corporation meets the distribution requirement.

A real estate mortgage investment conduit (REMIC) is an entity that holds a fixed pool of mortgages and issues multiple classes of ownership interests to investors. In general, a REMIC is treated in a manner similar to a partnership. Thus, the net income of a REMIC is taxable to the holders of the interests in the REMIC.

There are relatively few of these types of investment corporations operating in Wisconsin. In addition, any income not taxed to the corporation is generally taxed to the shareholders. Thus, the fiscal effect of this exemption device is minimal.

Double Weighting of the Sales Factor

Wisconsin requires multijurisdictional corporations to compute the amount of income taxable in this state through the use of a three-factor apportionment formula. The factors in the formula are based on the relationship of a company's property, payroll and sales in Wisconsin to the total property, payroll and sales in all jurisdictions. Each factor represents a ratio that is assigned a weight and then combined to yield a single income apportionment percentage.

Since 1974, Wisconsin has used an apportionment formula that double weights the sales factor. As such, the sales factor has a weight of 50% in the formula and each of the payroll and property factors are weighted at 25%. Double-weighting of the sales factor favors corporations with sales on a regional or national basis that have significant property and payroll in state.

The fiscal effect of this exemption device is the difference in tax liability under a double-weighted sales factor as compared to a formula that weights each factor equally. The revenue loss from tax savings to the corporations that benefit from double-weighting the sales factor is offset somewhat by revenue gains from the increased taxes paid by corporations that would have had lower tax liabilities if the sales factor was single-weighted.

"Throwback" Sales

A multistate corporation subject to tax in Wisconsin is required to treat certain "throwback" sales as Wisconsin sales when calculating its sales factor using the multistate apportionment formula. Throwback sales are sales originating in Wisconsin made to the federal government or to customers located in states where the seller is not subject to tax because of the nexus standards defined by federal law and interpreted by the Wisconsin Administrative Code.

Under the nexus standards, a corporation must have some type of operations in a state, generally in the form of property or employees, before its income can be taxed by that state. Without nexus, a state cannot tax a corporation. The throwback rule ensures that a corporation's entire income is subject to apportionment by the states with jurisdiction to tax. Without the throwback rule, sales to destination states in which the seller does not have nexus would not be included in the numerator of the sales factor of any state, and a corporation would be able to avoid paying tax on some of its income.

Sales shipped from Wisconsin to the federal government outside the state are thrown back to Wisconsin and single-weighted, as are sales shipped outside the state to taxpayers not within the income and franchise tax jurisdiction of the destination state. In-state sales to the federal government continue to be double-weighted.

The estimate is based on the difference of single weighting the throwback sales compared to double-weighting those sales under the regular apportionment formula.

Tax-Option Corporations

A tax-option corporation is a corporation with not more than 75 individual shareholders that elects Subchapter S treatment under Section 1362 of the Internal Revenue Code. Under Subchapter S, the corporation is exempt from tax at the corporate level and the net income is taxed to the individual shareholders under the individual income tax on a pro rata basis. The net income is taxed to the shareholders regardless of whether the corporation makes any actual distributions to the shareholders. In general, Subchapter S corporations are treated in a manner similar to partnerships, and items of income retain their character as they flow through to the shareholders.

Most federal Subchapter S corporations are automatically treated as tax-option corporations for state purposes. However, Subchapter S corporations can elect to be treated as regular corporations for state purposes under certain conditions. Regular corporations converting to Subchapter S or tax-option treatment are subject to a special tax on built-in gains for both federal and state purposes. Effective with tax years beginning on or after January 1, 1989, tax-option corporations and their shareholders can no longer deduct state taxes in calculating net income.

The estimate reflects the revenue loss from taxing shareholders on their individual income tax returns at lower rates, rather than taxing the business at the higher corporate tax rate.

Limited Liability Companies

Limited liability companies (LLCs) are a type of business entity that may be taxed similar to corporations or partnerships, depending on how they are structured. If taxable as a partnership, owners of an LLC (called members) are taxed on the flow-through income of the company at lower individual rates, rather than at the higher corporate rate. However, if taxable as a corporation, an LLC is taxed at the entity level using the corporate income tax rate.

DEDUCTIONS FROM GROSS INCOME

A deduction is an amount subtracted from Wisconsin gross income (or total income) to establish Wisconsin taxable income—the amount to which the tax rate is applied.

Deductions Which Further Define Net Income

Section 71.23 of the Wisconsin Statutes subjects corporations to a tax on or measured by their net income. Net income is defined as gross income less allowable deductions. The very nature of the corporate tax thus requires that income be reduced by certain current expenses and allocated costs. These expenses include: wages and salaries, taxes, repairs, rents, interest, and the cost of employee benefits. These expenses are generally legitimate business outlays.

Amortization and Other Special Cost Recovery Allowances

The cost associated with the consumption of an asset can be recovered in several ways. When an asset has a fixed life, costs are generally recovered through depreciation, which is discussed later in this section. For assets with indeterminate lives, the cost recovery methods include amortization, depletion and special cost recovery allowances. In addition, special cost recovery provisions apply for other types of costs that otherwise would not be recovered until the asset is disposed of, income is received for the product or service for which the cost was incurred, or the corporation is dissolved. The costs are eligible for recovery techniques that allow taxpayers to recover costs sooner than would otherwise be allowed.

1. **Pollution control facilities.** The cost of certain pollution control facilities can be amortized over a period of five years. To qualify, the pollution control facility must be used in connection with a plant in operation prior to 1976.
2. **Circulation expenditures.** Costs (other than costs to acquire land, depreciable property and part of the business of other newspapers or periodicals) to establish, maintain or increase the circulation of newspapers and periodicals can be deducted in the year paid.
3. **Research and development expenditures.** Costs of noncapital research and experimental activities can be deducted in the year paid or amortized over a period of five years (see also the discussion of noncapital expenditures under the Research Expenditures Credit in the section on "Credits").
4. **Soil and water conservation expenditures.** Taxpayers engaged in farming can deduct, in the year paid, the costs of soil and water conservation practices that are consistent with a conservation plan approved by the Soil Conservation Service of the U.S. Department of Agriculture. The deduction cannot exceed 25% of gross income from farming.
5. **Lease acquisition.** The cost of acquiring a lease, including renewal options, can be deducted in the year paid.
6. **Fertilizer expenditures.** Taxpayers engaged in farming can deduct the cost of fertilizers, lime and other materials used to condition land utilized in farming in the year paid.
7. **Architectural barriers to disabled people.** Up to \$15,000 of costs to remove architectural and transportation barriers to the disabled and elderly can be deducted in the year paid.
8. **Tertiary injectants.** Costs of tertiary injectants, used as part of tertiary recovery methods for oil and gas, can be deducted in the year paid.
9. **Reforestation expenditures.** Up to \$10,000 of costs to reforest qualified timber property can be amortized over a period of seven years.
10. **Start-up expenditures.** Costs of incorporating the taxpayer's business and issuing stock for the business can be amortized over a period of five years.
11. **Computer software.** Costs of developing computer software (whether for resale or taxpayer's personal use) can be deducted in the year paid or amortized over a period of five years. For purchases of computer software made after August 10, 1993, the capitalized cost of the software is ratably amortized over 15 years if the software purchased: (1) is not available for purchase by the general public or acquired as part of the purchase of a business; (2) is part of an exclusive license; and (3) has been extensively modified. Computer software purchased after August 10, 1993, and not meeting this test is ratably amortized over three years. For earlier acquisitions, a five-year amortization period applies.
12. **Intangible drilling costs.** Operators of a domestic oil, gas, or geothermal well may elect to expense intangible drilling and development costs, rather than capitalizing the costs through depletion or depreciation. For operators of wells located outside the U.S., costs can be recovered over a 10-year, straight-line amortization schedule or added to the adjusted basis of the property for cost depletion, at the choice of the taxpayer.

13. Mine exploration and development. A portion of the costs of exploring for energy and mineral deposits and developing such deposits for mining or drilling can be deducted in the year paid. The remaining portion is amortized over a period of five years.

Depletion allowances are provided to allow taxpayers to recover the costs of capital investment in natural resources. Under the cost depletion method, the acquisition costs are divided by the estimated number of units that the deposit or resource will produce. Taxpayers are allowed an annual deduction equal to the current year's production multiplied by the per unit depletion cost. Federal law also allows taxpayers the option of using percentage depletions, which provides taxpayers with an annual deduction equal to a percentage of the gross income from the current year's production.

For state purposes, only cost depletion is allowed. Since cost depletion does not allow for rapid cost recovery in the way that percentage depletion does, cost depletion is not considered an exemption device.

The special expensing provision for depreciable property under Section 179 of the Internal Revenue Code is discussed under Depreciation in this section.

Charitable Contributions

Contributions by corporations to the following charities are deductible from gross income:

- The state or any other political subdivision, as long as the gift is for strictly public purposes.
- A corporation, trust or community chest, fund or foundation operating for strictly religious, charitable, scientific, literary or educational purposes, or for fostering national or international sports competition, or for the prevention of cruelty to children or animals.
- Veterans' organizations and an auxiliary unit, society, trust or foundation of such organizations.
- Member-owned or nonprofit cemetery corporations chartered solely for burial purposes.

Certain limitations apply to the amount of contributions that can be claimed as a deduction and to the amount that can be deducted for contributions of property. In general, the deduction for charitable contributions cannot exceed 10% of a corporation's taxable income. Amounts of contributions not deductible in the current year can be carried forward for five years and claimed as a deduction.

Depreciation—Modified Accelerated Cost Recovery Systems

Depreciation deductions are allowed to reflect the reasonable expenses incurred by taxpayers for exhaustion, wear and tear of property used in a trade or business or held for the production of income. Effective for tax year 1987, the state adopted the Modified Accelerated Cost Recovery System (MACRS), enacted as part of the federal Tax Reform Act of 1986. However, property placed in service prior to that time must continue to be depreciated according to the state restrictions in effect at the time the property was placed into service.

Under MACRS, eligible property is generally assigned to a depreciation recovery class of 3 years, 5 years, 7 years, 10 years, 15 years or 20 years, 25 years, 27.5 years, 31.5 years or 39 years, depending upon the type of property. The cost of the property is recovered using statutory recovery methods and conventions.

With some restrictions, Section 179 rules allow taxpayers to expense in the current year up to \$24,000 (for tax year 2002) of the cost of tangible personal property. The maximum amount that may be expensed will increase to \$25,000 for 2003 and subsequent tax years. To qualify as Section 179 property, the property must be acquired by purchase for use in the active conduct of a trade or business (section 1245 depreciable property). The total cost of the property expensed under this election cannot exceed the total amount of taxable income derived from the active conduct of any trade or business during the tax year. However, excess amounts may be carried forward an unlimited number of years, subject to the ceiling each year.

Wisconsin has not adopted the 30% bonus depreciation provisions contained in the Job Creation and Worker Assistance Act of 2002.

The fiscal effect of the accelerated depreciation exemption device relates to the revenue impact of allowing more generous depreciation write-offs in comparison to the allowable deductions under the straight-line depreciation method.

Dividends

Dividends paid are generally not deductible by the payor corporation except for:

- Amounts paid as dividends or earnings to depositors' accounts by savings and loan associations, mutual loan corporations or mutual savings banks.
- Amounts distributed to patrons of businesses operating on a cooperative basis in proportion to their patronage, rather than stock or ownership. This type of dividend amounts to nothing more than a delayed discount for purchases made.

Dividends received are deductible in full by the recipient corporation if the payor corporation is a controlled subsidiary in which the recipient parent corporation owns at least 70% of the voting stock. The payor corporation is not allowed to subtract the dividends paid in determining its Wisconsin taxable income.

Bad Debt Reserves of Financial Institutions

In general, corporations can deduct bad debts only as the debts become worthless. Savings and loan associations, mutual savings banks, and other savings institutions may deduct additions to a reserve account for bad debts in lieu of deducting bad debts as they are experienced. Banks are also allowed to deduct additions to bad debt reserves, provided that the assets of the bank do not exceed \$500 million.

The deduction for additions to bad debt reserves is generally based on the average ratio of bad debts actually incurred to total loans outstanding for the five preceding taxable years. The tax benefit from this provision is that financial institutions using the reserve method can deduct bad debts before they actually become worthless.

Net Operating Loss Carryforward

Wisconsin authorizes corporations to carry net operating losses incurred in the current year forward for up to 15 years to offset net income in future years. Federal law allows losses to be carried forward 20 years or carried back two years. This treatment acts to smooth out fluctuations in corporate profits, which may change dramatically with economic conditions. Similar to federal law, prior year losses must be applied against income to the maximum extent possible and in a consecutive fashion during the carryover period. Losses from the earliest years are always used first.

CREDITS

A credit is an amount subtracted directly from the taxpayer's Wisconsin gross tax liability (i.e., the amount determined by applying the Wisconsin tax rate to Wisconsin taxable income) to determine the Wisconsin net tax liability. Generally, corporate tax credits are nonrefundable, that is, used only to reduce the amount of tax otherwise due.

Credit for Sales Tax on Fuel and Electricity Used in Manufacturing

A nonrefundable credit can be claimed for the amount of Wisconsin sales tax paid on fuel and electricity consumed in manufacturing tangible personal property in the state. The credit is designed to be the equivalent of a sales tax exemption. Unused amounts of credit can be carried forward and offset against tax liability over the next 15 years. Corporations must increase their net income by the amount of credit claimed in lieu of reducing their deduction for the sales tax portion of the expense of fuel and electricity.

Research Expenditures Credit

A nonrefundable research expenditures credit for noncapital expenditures for research-related activities conducted in Wisconsin is available to corporations. The credit is patterned after the federal research credit and is equal to 5% of the excess of qualified research expenses for the current year over a base period amount. Qualifying expenditures are defined by reference to the rules established under Section 41 of the Internal Revenue Code. Expenses must be incurred in connection with research conducted in Wisconsin in order to qualify for the credit. The "base period amount" is calculated in the same manner as that for the federal credit, except that the gross receipts used in computing the state credit are from sales attributable to Wisconsin, other than throwback sales, for purposes of apportionment. Unused amounts of the credit can be carried forward for up to 15 years.

The credit applies only to research expenditures that are undertaken to discover information that is technological in nature and intended to be useful in the development of a new or improved business component. Qualified research expenses cover in-house expenses for the taxpayer's own research (wages, supplies and computer use charges) and 65% of amounts paid or incurred for qualified research done by a person other than an employee of the taxpayer.

Research Facilities Credit

The research facilities credit applies to capital investments to construct and equip new research facilities or to expand existing facilities located in Wisconsin. The credit is equal to 5% of the amount of qualified investment in tangible depreciable property that is not replacement property.

The rules relating to the credit are similar to the rules for the research expenditures credit. The credit is nonrefundable, and unused amounts of credit may be carried forward and offset against tax liability over the next 15 years. Corporations must increase their net income by the amount of credit claimed in lieu of reducing their deduction for research expenses or reducing their basis in the property.

Supplement to Federal Historic Rehabilitation Credit

A nonrefundable credit is available to encourage the rehabilitation of historic buildings in Wisconsin. The state supplemental credit is equal to 5% of qualified rehabilitation expenditures, as defined under Section 48 (g) of the Internal Revenue Code, to substantially rehabilitate certified historic buildings for use in a trade or business. This program is more fully discussed in the chapter on "Individual Income Tax."

Development Zone, Development Opportunity Zone, Enterprise Development Zone, and Agricultural Development Zone Credits

Credits are available to corporate taxpayers who are certified by the Department of Development to participate in the Wisconsin development zone, development opportunity zone, enterprise development zone and agricultural development zone programs.

The *development zone program* provides credits to taxpayers that locate or expand a trade or business activity within a development zone. A development zone is an economically distressed area designated as a development zone by the Wisconsin Department of Commerce. Twenty-two zones have been designated, with authorized tax credits of \$38.155 million; these zone designations are in effect for a period of seven to ten years. Certified businesses are provided with a maximum amount of tax benefits and may claim the development zone credits up to that amount.

Under the *development opportunity zone* program, corporations, except insurance companies, conducting economic activities in this type of zone may claim tax credits allocated to them. These zones have a duration of three years. Six zones with \$29.4 million in tax credits have been authorized.

Enterprise development zones are areas in which a single business is permitted to operate and receive tax credits. A business planning to conduct economic activity in a specific area of the state can apply with the Department of Commerce to have the area designated as an enterprise zone. Designation is based on criteria relating to high unemployment and poverty, declining property values and declining population, and is for a period of three years. The Department of Commerce has authority to designate up to 79 enterprise development zones;

at least 10 of the zones must be for environmental remediation. Each zone is allocated a maximum of \$3 million credits, so that total credits under the program may total as much as \$237 million. Sixty-six enterprise development zones have been authorized with \$122.5 million of credit allocated.

Beginning in 2003, the Department of Commerce may certify one zone as an *agricultural development zone*. The area must be located in a rural municipality and the zone designation will be in effect for ten years. The area may be certified for up to \$5 million of credits.

In 1998, eight separate credits were replaced by a consolidated credit for creation or retention of full-time jobs and for environmental remediation in a zone. The consolidated credit is comprised of the following components:

- Up to \$8,000 for each full-time job created or retained by a member of a target group;
- Up to \$6,000 for each full-time job created or retained and filled by a person who is not a member of a target group; and
- Up to 50% of amounts spent for environmental remediation.

A member of a target group includes a person employed in unsubsidized or trial jobs under the Wisconsin Works program, a person qualifying for the Wisconsin Works health plan or child assistance, a vocational rehabilitation referral, an economically disadvantaged veteran, an economically disadvantaged ex-convict, a social security insurance recipient, a food stamp recipient, or a dislocated worker.

Beginning in tax year 2000, an investment credit is available to taxpayers in a development opportunity zone. The credit equals 2.5% of the purchase of depreciable tangible personal property (1.75% of the price if the property has been expensed under section 179 of the Internal Revenue Code). Beginning in 2002, a 3% capital investment credit is available to taxpayers in development opportunity zones located in Milwaukee and Beloit and in the agricultural zone.

Technology Zone Credit

Beginning in 2002, a credit is available for businesses certified by the Department of Commerce and located in a technology zone. Commerce may certify up to eight technology zones, each for up to \$5 million in credits. All eight zones have been designated.

The credit has the following components:

- The amount of real and personal property taxes imposed and paid in the taxable year,
- The amount of income and franchise taxes imposed and paid in the taxable year, and
- The amount of sales and use taxes imposed and paid in the taxable year.

Farmland Tax Relief Credit

A farmland tax relief credit equal to a percentage, established by the Department of Revenue, of property taxes up to \$10,000 on farmland, exclusive of improvements, is allowed for owners of farmland. This credit is refundable. The credit percentage is set so that the amount expended for the credit for all claimants, individual and corporate, is \$15 million, adjusted for underspending or excess spending in the prior fiscal year. For taxes levied in 2002, it will be 13%. This estimate represents claims by corporate taxpayers. More detail on the credit appears in the Individual Income Tax chapter.

Farmland Preservation Credit

Corporations are eligible for Farmland Preservation Credits and must meet basically the same requirements as individual taxpayers (see Individual Income Tax chapter). Household income for corporations is defined as the sum of net corporate income, any business loss carryforward allowed under section 71.26 (4), Wis. Stats., and the household income of each corporate shareholder including the income of spouse, dependents and other members of the household. Corporations must include in their household income farm depreciation in excess of \$25,000, all nonfarm depreciation and nonfarm business losses. The credit is refundable.

Investments in the Community Development Finance Company

A credit is allowed for capital investments in the Wisconsin Community Development Finance Company. Eligibility for the credit is restricted to taxpayers who have made a contribution to the Community Development Finance Authority (CDFA). The credit is equal to 75% of the cost of common stock or a partnership interest purchased in the Community Development Finance Company. The base for computing the credit is limited to the value of the claimant's contribution to the CDFA.

The credit is nonrefundable and unused amounts of credit can be carried forward and offset against tax liability over the next 15 years. Taxpayers must increase their income by the amount of the credit claimed in lieu of reducing their deduction for the contribution to the CDFA.

The CDFA was repealed by 1987 Wisconsin Act 399. Beginning in 1988, the credit applies to capital investments in the Wisconsin Housing and Economic Development Authority (WHEDA).

Insurance Security Fund Assessments

Chapter 646, Wisconsin Statutes, provides a credit against state taxes, including the corporate income and franchise tax, for certain assessments levied on insurance companies by the Wisconsin Insurance Security Fund. The fund is designed to protect policyholders in cases where their insurance company has failed and is in the process of liquidation. Where the available assets and reserves of failed insurers are inadequate to meet claims, the fund may assess insurance companies doing business in the state, with some exceptions (e.g., fraternal benefit societies). Such assessments are eligible for a 100% tax credit if they cannot be recovered through higher premiums. This can occur where premiums are fixed on a particular line of business. Credits claimed by foreign insurance companies and domestic life companies would be offset against the premiums tax. Thus, the only offsets against the income and franchise tax would be for credits claimed by domestic property and casualty companies. The tax credit is nonrefundable and must be claimed in equal installments over a five-year period, beginning with the year following the one in which the assessment is made.

RECYCLING SURCHARGE

Introduction

Effective for tax years beginning on or after January 1, 2000, Wisconsin imposes a recycling surcharge on all non-farm businesses with gross receipts of at least \$4 million. The surcharge is imposed at a rate of 3% on gross tax liability for corporations and 0.2% of net business income for noncorporate business entities. The maximum surcharge is \$9,800 and the minimum is \$25. Noncorporate farms are exempt from the surcharge if their gross receipts from farming are no more than \$1,000,000, and pay a minimum surcharge of \$25 if not exempt. The surcharge does not apply to entities not required to file an income tax return.

Revenues from the recycling surcharge are deposited in the segregated recycling fund, and used to fund local government recycling and solid waste management programs and private business efforts to develop recycled products or markets related to these products. Collections for FY02 were \$12.5 million. Data is not available to estimate the fiscal effect of the exemptions.

TABLE 1
RECYCLING SURCHARGE EXEMPTION DEVICES SUMMARY

| Exemption Devices | Statutory Reference* | FY02 Fiscal Effect |
|--|----------------------|--------------------|
| Exemptions from Taxation | | |
| Exempt Corporations | s. 77.93 (1) | Not available |
| Exempt Individuals, Estates and Trusts | s. 77.93 (2) | Not available |
| \$4 Million Gross Receipts Exemption | s. 77.94 (1)(b) | Not available |
| Members of the Clergy and Certain Religious Groups | s. 77.92 (5) | Not available |
| Special Treatment | | |
| \$9,800 Surcharge Limit | s. 77.94 (1) | Not available |
| Farming Surcharge of \$25 | s. 77.94 (1)(c) | Not available |

* References to sections of the 2001 Wisconsin Statutes.

EXEMPTIONS FROM TAXATION

Exempt Corporations

Corporations that are exempt from the corporate income and franchise tax under section 71.26 (1), Wis. Stats., and that have no unrelated business income reportable under section 71.24 (1m), Wis. Stats., are exempt from the surcharge. This exemption applies to not-for-profit entities.

Exempt Individuals, Estates and Trusts

The surcharge does not apply to natural persons, estates or trusts that are not required to file a return because their income is less than the filing requirements under Subchapter I or II of Chapter 71, Wis. Stats. Of those filing, also exempt are persons who are not employees as defined in section 3121 (d)(3) of the Internal Revenue Code or not filing a form indicating a profit or loss from a trade or business for federal income tax purposes.

\$4 Million Gross Receipts Exemption

Businesses with less than \$4 million of gross receipts are exempt from the surcharge.

Members of the Clergy and Certain Religious Groups

Members of the clergy and members of certain recognized religious groups who perform services or duties as defined by section 1402 (c)(4) and (5) of the Internal Revenue Code are exempt from the recycling surcharge.

SPECIAL TREATMENT**\$9,800 Surcharge Limit**

The maximum surcharge that any taxpayer will pay is limited to \$9,800. This is considered an exemption device because the amount of surcharge that is collected is less than it would be had the surcharge been collected under the existing rates without the maximum.

Farming Surcharge of \$25

All natural persons, estates, trusts, partnerships, and limited liability companies that are engaged in farming, except entities that have gross receipts from farming of no more than \$4 million, are subject to a surcharge of \$25 regardless of the amount of net farm profit. If the surcharge was applied to noncorporate farms in the same manner as it is to other noncorporate business entities, it is estimated that no farms would be subject to the surcharge.

SALES AND USE TAX

Introduction

Wisconsin imposes a 5% tax on the sale or use of most items of tangible personal property and on selected services. The state first imposed a 3% selective sales and use tax in 1962 but replaced it with a 4% general sales and use tax in 1969. The current 5% rate has been in effect since 1982.

The initial 3% tax was selective in that goods subject to the tax were specifically identified in the statutes: household furnishings, motor vehicles, jewelry, tobacco, fermented malt beverages, intoxicating liquors and food sold in restaurants were taxable. The general tax imposed in 1969, in contrast to the selective tax, falls on sales of all tangible personal property, except property specifically exempted by law. The sales tax remains selective in its treatment of services, imposed only on those services specifically identified as taxable in the statutes.

Numerous changes to the sales tax base have been made over the years. Exemptions are discussed in detail in the latter half of this chapter and estimates of fiscal effects are provided. Expansions of the sales and use tax base include:

- Cigarettes (1975);
- Cable television, including installation (1975);
- Interstate telephone and telegraph services, and landscaping and lawn maintenance services (1982);
- Magazines other than those sold by subscription (1983);
- Telephone company central office equipment and coin-operated telephone services (1996);
- Telephone answering and messaging services, and telecommunications services terminating in and billed to a service address in the state (1997).

The 5% sales tax is imposed on retailers for the privilege of selling, leasing or renting tangible personal property that is not specifically exempt from tax. In addition, a 5% use tax is imposed on the storage, use or other consumption in this state of tangible personal property that is purchased out-of-state and is not specifically exempt. The use tax complements the sales tax in that, without a use tax, consumers would be able to avoid sales tax by purchasing goods out-of-state. Thus, the use tax ensures that the sales tax does not place Wisconsin merchants at a competitive disadvantage compared with those in other states.

Taxable Services

The law imposes a sales tax on selected services. Unlike tangible personal property, sales of which are taxable unless specifically exempt, services are not subject to the sales tax unless specifically identified in the statutes. The following services are taxable:

- Rooms or lodging for less than one-month by hotelkeepers, motel operators and other persons furnishing accommodations to the public.
- Admissions to amusement, athletic, entertainment or recreational events or places. Admissions to places or events considered educational in nature, such as museums or zoos, and admissions to county fairs are exempt from sales tax.
- Telecommunications services originating or terminating in Wisconsin and charged to a service address in the state, including coin-operated telephone services. Prepaid telephone cards or authorization numbers

are taxed at the time of purchase; services obtained through the use of cards or authorization numbers are not taxable.

- Laundry, dry cleaning, pressing and dyeing services, except when performed on raw materials, on goods in process or on cloth diapers by a diaper service, and except when performed by the customer through the use of coin-operated, self-service machines.
- Photographic services, including the processing, printing and enlarging of film, and the services of photographers for the taking, reproducing and sale of photographs.
- Parking or providing parking space for motor vehicles and aircraft, and docking or providing storage space for boats.
- The repair, inspection and maintenance of tangible personal property, and the installation of tangible personal property, except when such installation constitutes a capital improvement.
- The production, printing or imprinting of tangible personal property for consumers who furnish directly or indirectly the materials used in such processes.
- Cable television services, including installation charges.
- Landscaping and lawn maintenance services.
- Telephone answering and messaging services.

Local Taxes

The law allows counties and professional football stadium districts to impose a 0.5% local sales and use tax and professional baseball park districts to impose a 0.1% sales and use tax. These local taxes are imposed on the same tax base as the state sales tax. As of January 1, 2003, 57 counties impose the 0.5% county sales tax.

The Southeast Wisconsin Professional Baseball Park District imposed a 0.1% sales tax in Milwaukee, Ozaukee, Racine, Washington and Waukesha Counties in 1996. Proceeds from this tax are used to finance Miller Park, the Milwaukee Brewers' home field. This tax will be discontinued upon retirement of the bonds issued to finance the ballpark and the funding of a maintenance and capital improvement fund for the ballpark.

The Green Bay-Brown County Professional Football Stadium District imposed a 0.5% sales tax in Brown County in 2000 to finance renovation of Lambeau Field. This tax will be discontinued upon retirement of the bonds issued to finance the stadium and the funding of a maintenance and capital improvement fund for the stadium.

Table 1 lists the state's 72 counties, the local sales taxes applicable in each county, the effective date of the county sales tax, and the combined state and local sales tax rate.

TABLE 1
LOCAL SALES AND USE TAXES AND COMBINED STATE-LOCAL TAX RATE BY COUNTY
JANUARY 1, 2003

| County | Local Taxes (Effective Date) | Combined State-Local Tax Rate | County | Local Taxes (Effective Date) | Combined State-Local Tax Rate |
|-------------|---------------------------------|-------------------------------------|-------------|---------------------------------|-------------------------------------|
| Adams | County (1/1/94) | 5.5% | Marathon | County (4/1/87) | 5.5% |
| Ashland | County (4/1/88) | 5.5% | Marinette | County (10/1/01) | 5.5% |
| Barron | County (4/1/86) | 5.5% | Marquette | County (4/1/89) | 5.5% |
| Bayfield | County (4/1/91) | 5.5% | Menominee | None | 5.0% |
| Brown | Football Stadium | 5.5% | Milwaukee | County (4/1/91), Ballpark | 5.6% |
| Buffalo | County (4/1/87) | 5.5% | Monroe | County (4/1/90) | 5.5% |
| Burnett | County (4/1/89) | 5.5% | Oconto | County (7/1/94) | 5.5% |
| Calumet | None | 5.0% | Oneida | County (4/1/87) | 5.5% |
| Chippewa | County (4/1/91) | 5.5% | Outagamie | None | 5.0% |
| Clark | None | 5.0% | Ozaukee | County (4/1/91), Ballpark | 5.6% |
| Columbia | County (4/1/89) | 5.5% | Pepin | County (4/1/91) | 5.5% |
| Crawford | County (4/1/91) | 5.5% | Pierce | County (4/1/88) | 5.5% |
| Dane | County (4/1/91) | 5.5% | Polk | County (4/1/88) | 5.5% |
| Dodge | County (4/1/94) | 5.5% | Portage | County (4/1/89) | 5.5% |
| Door | County (4/1/88) | 5.5% | Price | County (1/1/93) | 5.5% |
| Douglas | County (4/1/91) | 5.5% | Racine | Ballpark | 5.1% |
| Dunn | County (4/1/86) | 5.5% | Richland | County (4/1/89) | 5.5% |
| Eau Claire | County (1/1/99) | 5.5% | Rock | None | 5.0% |
| Florence | None | 5.0% | Rusk | County (4/1/87) | 5.5% |
| Fond du Lac | None | 5.0% | St. Croix | County (4/1/87) | 5.5% |
| Forest | County (4/1/95) | 5.5% | Sauk | County (4/1/92) | 5.5% |
| Grant | County (4/1/02) | 5.5% | Sawyer | County (4/1/87) | 5.5% |
| Green | County (1/1/03) | 5.5% | Shawano | County (4/1/90) | 5.5% |
| Green Lake | County (7/1/99) | 5.5% | Sheboygan | None | 5.0% |
| Iowa | County (4/1/87) | 5.5% | Taylor | County (7/1/99) | 5.5% |
| Iron | County (4/1/91) | 5.5% | Trempealeau | County (10/1/95) | 5.5% |
| Jackson | County (4/1/87) | 5.5% | Vernon | County (1/1/97) | 5.5% |
| Jefferson | County (4/1/91) | 5.5% | Vilas | County (4/1/88) | 5.5% |
| Juneau | County (4/1/92) | 5.5% | Walworth | County (4/1/87) | 5.5% |
| Kenosha | County (4/1/91) | 5.5% | Washburn | County (4/1/91) | 5.5% |
| Kewaunee | None | 5.0% | Washington | County (1/1/99), Ballpark | 5.6% |
| LaCrosse | County (4/1/90) | 5.5% | Waukesha | Ballpark | 5.1% |
| Lafayette | County (4/1/01) | 5.5% | Waupaca | County (4/1/89) | 5.5% |
| Langlade | County (4/1/88) | 5.5% | Waushara | County (4/1/90) | 5.5% |
| Lincoln | County (4/1/87) | 5.5% | Winnebago | None | 5.0% |
| Manitowoc | None | 5.0% | Wood | None | 5.0% |

Administration and Collections

Sales tax is imposed on the gross receipts from retail sales; use tax is imposed on the amount paid for a good. Each retailer is responsible for paying sales tax, regardless of whether it is identified on the bill and collected directly from the customer. Every business that makes taxable sales is required to obtain a seller's permit from the department and pay a \$20 business tax registration fee, which also covers permits for other taxes.

Retailers are permitted to retain a portion of the taxes they collect as compensation for the costs they incur in collecting the tax. Since 1997 the retailer's discount has been 0.5% of the amount of tax liability if taxes are paid timely, with a minimum discount of \$10 per filing period. Retailers file monthly, quarterly or annually, depending on the amount of tax owed.

In contrast to the sales tax which is paid by the seller, use tax is paid by the purchaser. Corporations may file a use tax return or report use tax on the corporate income and franchise tax returns. Private individuals indicate their use tax liability on their individual income tax returns.

Collections of sales and use taxes have increased as the economy in general has grown and Wisconsin personal incomes have increased. In addition, the state tax rate has been increased and the tax base has been changed. Collections have increased from \$83 million in FY65 to \$3,696 million in FY02. Sales and use taxes provided 14% of general purpose tax revenues in FY65, but that share had risen to 36.8% in FY02.

Table 2 shows the source of sales taxes by type of business. In calendar year 2001, nearly two-thirds of sales taxes were collected from businesses engaged in wholesale or retail trade, service industries accounted for 14%, and transportation, communications and electric utilities 12%.

TABLE 2
2001 SALES AND USE TAX COLLECTIONS BY BUSINESS CODE
(INCLUDES INTEREST AND PENALTIES)

| SIC | Industry | Number of Filers | Amount (\$ Millions) | Percent Of Total |
|-------|---|------------------|----------------------|------------------|
| 0 | Agriculture, Forestry, Fisheries | 4,618 | \$21.58 | 0.61% |
| 1 | Mining, Construction | 5,661 | 95.14 | 2.69% |
| 2 | Manufacturing – Nondurable Goods | 1,698 | 37.86 | 1.07% |
| 3 | Manufacturing – Durable Goods | 5,521 | 88.80 | 2.51% |
| 4 | Transportation, Communications, Utilities | 1,513 | 410.34 | 11.62% |
| 5 | Wholesale, Retail Trade | 85,414 | 2,268.12 | 64.20% |
| 6 | Finance, Insurance, Real Estate | 936 | 17.11 | 0.48% |
| 7 | Hotel, Personal, Business Services | 35,512 | 407.92 | 11.55% |
| 8 | Professional Services | 12,450 | 85.32 | 2.42% |
| 9 | Government | 327 | 12.23 | 0.35% |
| | Occasional Sales | | 88.22 | 2.50% |
| | Total* | 153,650 | \$3,532.66 | 100.00% |
| | Additional Detail | | | |
| 48 | Telephone | 955 | \$209.70 | 5.94% |
| 49 | Electric, Gas | 153 | 197.43 | 5.59% |
| 50-51 | Wholesale Trade, Durable | 5,153 | 165.44 | 4.68% |
| 52 | Building Material, Hardware, Farm Equipment | 4,002 | 199.35 | 5.64% |
| 53 | General Merchandise | 723 | 336.19 | 9.52% |
| 54 | Food Stores | 3,024 | 146.18 | 4.14% |
| 55 | Auto Dealers, Service Stations | 5,645 | 520.47 | 14.73% |
| 56 | Clothing Stores | 1,789 | 94.59 | 2.68% |
| 57 | Furniture | 3,062 | 131.51 | 3.72% |
| 58 | Eating and Drinking | 13,430 | 254.90 | 7.22% |
| 59 | Miscellaneous Retail | 48,586 | 419.49 | 11.87% |
| | Subtotal* | 86,522 | \$2,675.26 | 75.73% |

* Details may not sum to totals due to rounding.

Calculations of Exemptions

This report describes each sales tax exemption and, where feasible, estimates its fiscal effect in FY02. In general, fiscal effects were estimated by obtaining or estimating the gross receipts from retail sales for the most recent year available and adjusting those receipts to FY02 levels using income and price data. When possible, state-specific data from state and federal agencies and trade organizations with statewide membership or information were used. For some exemptions, state receipts were not available, but were estimated from national sales data using the Wisconsin share of the nation's population, personal income or a similar indicator. For some exemptions, data permitting an estimate are not available. For others, no estimate is made because the state is precluded from taxing the sale—for example, sales to the federal government, which are exempt under the U.S. Constitution.

The significance of these exemptions may be viewed in the perspective of sales and use tax collections, which were \$3,696 million in FY02. Thus, the exemption for food, which is estimated to cost \$455 million, represents 12.3% of FY02 sales and use tax collections.

**TABLE 3
SALES AND USE TAX EXEMPTION DEVICES SUMMARY**

| Exemption | Statutory Reference* | FY02 Fiscal Effect |
|---|---|--------------------|
| Exemptions for Property Sold Primarily to Households | | |
| Food | s. 77.54 (20) and (20m) | \$455,000,000 |
| Meals Furnished by Institutions of Higher Education | s. 77.54 (20) (c) 5 | 3,500,000 |
| Water Sold Through Mains | s. 77.54 (17) | 23,000,000 |
| Fuel and Electricity for Residential Use | ss. 77.54 (30) (a) 1 and 2 | 99,100,000 |
| Long-Term Rental Payments for Residential Real Estate | s. 77.52 (2) (a) 1 | 215,000,000 |
| Manufactured Homes and Mobile Homes Used as Primary Housing | ss. 77.51 (4) (b) 6 and 7, (15) (b) 5 and 6, 77.54 (31) | 2,000,000 |
| Motor Fuels | s. 77.54 (11) | 240,000,000 |
| Newspapers, Periodicals and Shoppers Guides | s. 77.54 (15) | 15,000,000 |
| Caskets and Burial Vaults | s. 77.54 (21) | 4,100,000 |
| U.S. and State of Wisconsin Flags | s. 77.54 (46) | 100,000 |
| Coin-Operated Laundry and Dry Cleaning Services | s. 77.52 (2) (a) 6 | 2,600,000 |
| Cloth Diapers and Diaper Services | ss. 77.51 (1m) and (3m), 77.52 (2) (a) 6 and 77.54 (40) | 40,000 |
| Exemptions Related to Health Care | | |
| Prescription Drugs and Medicines | s. 77.54 (14) | 107,000,000 |
| Equipment used in the Treatment and Testing of Diabetes | ss. 77.54(14m) and (28) | 1,600,000 |
| Medical Devices (inc. Wheelchairs, Home Oxygen Equipment) | ss. 77.54 (14s) and (22) | 13,500,000 |
| Accommodations Provided by Hospitals, Nursing Homes, Nonprofit Associations and Religious Organizations | ss. 77.52 (2) (a) 1 | 86,100,000 |
| Meals Provided by Nursing Homes Community-Based Residential Facilities and Hospitals, and Food Sold in Retirement Homes | ss. 77.54 (20) (c) 4 | Not applicable |
| Exemptions Related to Farming | | |
| Tractors and Farm Machinery | s. 77.54 (3)(a) | 31,600,000 |
| Electricity Used in Farming | ss. 77.54 (30) (a) 3 | 5,800,000 |
| Fuel Used in Farming | ss. 77.54 (30) (a) 5 | 6,100,000 |
| Veterinary Services and Medicines for Farm Livestock | ss. 77.52 (2) (a) 10 and 77.54 (33) | 5,400,000 |
| Semen for Livestock Breeding | s. 77.54 (27) | 1,900,000 |
| Milkhouse Supplies | s.77.54 (34) | 5,600,000 |
| Exemptions Related to Nonfarm Businesses | | |
| Machinery and Equipment Used in Manufacturing | ss 77.54 (5) (d) and (6) (a) | 167,000,000 |
| Waste Treatment Facilities | s. 77.54 (26) | 20,400,000 |
| Machinery and Equipment Used in Recycling | s. 77.54 (5) (c) and (26m) | Not available |
| Logging Equipment | s. 77.54 (39) | 600,000 |
| Equipment Used in the Production of Maple Syrup | s. 77.54 (29) | Minimal |
| Wood Term Rental Payments for Real Estate Used for Business Purposes | s. 77.54 (30) (a) 4 | 170,000 |
| Long-Term Rental Payments for Real Estate Used for Business Purposes | s. 77.52 (2) (A) 1 | 365,000,000 |
| Building Materials, Equipment and Supplies Used in the Construction of Professional Sports Stadiums | s. 77.54 (41) | 3,100,000 |
| One-time License or Right to Purchase Admissions to Professional Football Games | s. 77.54 (45) | 170,000 |

TABLE 3 (continued)
SALES AND USE TAX EXEMPTION DEVICES SUMMARY

| Exemption | Statutory Reference* | FY02 Fiscal Effect |
|---|-------------------------------------|---------------------------|
| Exemptions Related to Nonfarm Businesses | | |
| Trucks, Tractors, Buses and Other Vehicles Sold to Common or Contract Carriers | s. 77.54 (5) (b) | 20,200,000 |
| Commercial Vessels and Barges | s. 77.54 (13) | 2,200,000 |
| Rolling Stock Used in Railroad Operations | s. 77.54 (12) | 6,600,000 |
| Motion Picture and TV Film and Advertising Materials | s. 77.54 (23m) | 8,200,000 |
| Restaurant Employee Meals | s. 77.54 (20) (c) 4m | Not available |
| Tangible Personal Property Purchased for Resale but Donated to a Nonprofit Organization | s. 77.56 (3) | Not available |
| Prepaid Telephone Cards and Authorization Numbers | s. 77.54 (46m) | Not available |
| Exemptions for Government Agencies and Nonprofit Organizations | | |
| Sales to the Federal Government and Its Agencies | s. 77.55 (1) | Not applicable |
| Sales to State and Local Governments and Schools | s. 77.54 (9a) (a) to (em), (g), (h) | 252,000,000 |
| Volunteer Fire Department Equipment | s. 77.54 (16) | Not available |
| Motor Vehicles Loaned to Driver Education Programs | s. 77.56 (2) | Not available |
| Religious, Charitable, Scientific and Educational Organizations | s. 77.54 (9a) (f) | 86,100,000 |
| Snowmobile Trail Grooming Equipment | s. 77.54 (38) | Minimal |
| Charges for Emergency Telephone Systems | s. 77.54 (37) | 500,000 |
| Admissions to Elementary and Secondary School Activities | s. 77.54 (9) | 600,000 |
| Hot Lunches and Other Tangible Personal Property Sold by Elementary and Secondary Schools | s. 77.54 (4) | 8,500,000 |
| Copies of Public Records | s. 77.54 (32) | Not available |
| Sales of Animal Identification Tags and Samples by the Department of Agriculture, Trade and Consumer Protection | s. 77.54 (42) | 16,000 |
| State Park Admission and Camping Fees | s. 77.54 (10) | 600,000 |
| Admissions to Certain Historical Museums | s. 77.54 (10) | 37,000 |
| Admissions to County Fairs | s. 77.52 (2) (a) 2 | Not available |
| Sales by American Legion Baseball Teams | s. 77.54 (35) | Not available |
| Exemptions for Nonresidents and for Use in Other States | | |
| Interstate Commerce | s. 77.54 (1) | Not applicable |
| Property used in the State by Nonresidents | s. 77.53 (17) | Not available |
| Nonresidents' Boats Berthed in Boundary Waters | s. 77.53 (17m) | Not available |
| Nonresidents' Aircraft Hangared in Wisconsin | s. 77.53 (17r) | Not available |
| Goods Brought into the State by New Residents | s. 77.53 (18) | Not available |
| Property Purchased for Use Outside the State | s. 77.55 (3) | Not available |
| Aircraft Sold for Use in Interstate Commerce | s. 77.54 (5) (a) | Not available |
| Aircraft, Motor Vehicles and Truck Bodies Sold for Use Outside the State | s. 77.54 (5) (a) | Not available |
| Property Sold to Out-of-State Common or Contract Carriers | s. 77.55 (2) and (2m) | Not available |
| Printed Advertising Material Used Outside the State | s. 77.54 (25) | Not available |
| Temporary Storage of Printed Materials | s. 77.54 (43) | Not available |

TABLE 3
SALES AND USE TAX EXEMPTION DEVICES SUMMARY (continued)

| Exemption | Statutory Reference* | FY02 Fiscal Effect |
|--|--|--------------------|
| Definitional and Miscellaneous Exemptions | | |
| Exemptions That Further Define Retail Sales | Various sections (see text) | Not applicable |
| Labor Input into Construction | ss. 77.51 (4) (c) 4 and 77.52 (2) (a) 10 | 450,000,000 |
| Trade-Ins | s. 77.51 (4) (a) 3 | 140,000,000 |
| Transportation Charges | ss. 77.51 (4) (b) 5 and (15) (b) 3 | Not available |
| Occasional Sales | s. 77.54 (7) and (7m) | Not available |
| Auction Sales | ss. 77.51 (9) (e) and 77.54 (7) | Not available |
| Retailer's Discount | s. 77.61 (4) (b) and (c) | 21,500,000 |

* References to sections of the 2001 Wisconsin Statutes.

EXEMPTIONS FOR PROPERTY SOLD PRIMARILY TO HOUSEHOLDS

Food

Sales of food, food products and beverages purchased for home consumption are exempt from sales tax. However, items such as candy, soda water beverages, beer, wine and liquor are taxable. Sales from vending machines of food, food products and beverages are treated as sales for home consumption. When exempt food items are packaged with taxable items, the package is exempt if at least 50% of the price is attributable to the exempt items. Meals sold in restaurants, cafes and cafeterias are taxable.

Meals Furnished by Institutions of Higher Education

Sales of meals, food and beverages furnished by public and private institutions of higher education are exempt from sales tax if they are furnished to students in that institution or under an agreement with a National Football League team.

Water Sold Through Mains

Sales of water delivered through mains and all water provided by public and private water utility districts are exempt from the sales tax.

Fuel and Electricity for Residential Use

All sales for residential use of coal, fuel oil, propane, steam, peat, fuel cubes produced from solid waste and wood used for fuel are exempt from sales tax. Sales of electricity and natural gas for residential use billed from November through April are also exempt from sales tax.

Long-Term Rental Payments for Residential Real Estate

Rental payments for accommodations rented for a continuous period of more than one month, including rentals of mobile homes, are exempt from the sales tax. Rental payments for real estate are generally not subject to the sales tax, although the tax is imposed on rentals of hotel and motel accommodations for periods of less than one month.

Manufactured Homes and Mobile Homes Used as Primary Housing

Thirty-five percent of the sales price of a new mobile home used as primary housing is exempt from sales tax if the home is at least 45 feet in length, or is transported in two sections with a total area of 984 square feet. Sales of used mobile homes used as primary housing and meeting these size requirements are fully exempt.

A portion of the sales price of a manufactured home, equal to either 35% of the price or the gross receipts less the amount attributable to materials, is also exempt.

Motor Fuels

Sales of motor fuels that are subject to the state motor fuel excise tax are exempt from the sales tax. Exempt fuels include gasoline, commercial and general aviation fuel and diesel fuel.

Newspapers, Periodicals and Shoppers Guides

Sales of newspapers, periodicals sold by subscription, and shoppers guides that distribute at least 48 issues in a 12-month period are exempt from sales tax. The exemption for newspapers and periodicals is generally limited to those published four or more times per year; periodicals issued at intervals not exceeding six months by an educational association or tax-exempt religious, charitable, scientific or educational organization are also exempt.

Caskets and Burial Vaults

Sales of caskets and burial vaults are exempt from the sales tax.

United States of America and State of Wisconsin Flags

Sales of U. S. and Wisconsin flags are exempt from the sales tax.

Coin-Operated Laundry and Dry Cleaning Services

Laundry services performed by customers using coin-operated equipment are exempt. Gross receipts from laundry, dry cleaning, pressing and dyeing services performed on raw materials in process and destined for sale are also exempt.

Cloth Diapers and Diaper Services

Gross receipts from the sale or rental of cloth diapers and gross receipts of diaper services are exempt.

EXEMPTIONS RELATED TO HEALTH CARE

Prescription Drugs and Medicines

Sales of medicines are exempt from the sales and use tax if the medicines are: (1) prescribed for treatment by an authorized person or dispensed by a registered pharmacist; (2) furnished by a licensed physician, surgeon, podiatrist or dentist to his own patient; (3) furnished by a hospital for treatment of patients on the orders of a licensed physician, surgeon, podiatrist or dentist; (4) sold to a licensed physician, surgeon, podiatrist or dentist for treatment of patients; (5) sold to this state for use in treatment of human beings or furnished by a medical facility maintained by the state; or (6) furnished without charge to a physician, surgeon, nurse anesthetist, advanced practical nurse, osteopath, dentist, podiatrist or optometrist if the medicine may not be dispensed without a prescription.

Equipment Used in the Treatment and Testing of Diabetes

Apparatus used for the injection of insulin, other equipment used to treat diabetes, and equipment and supplies used to measure blood sugar levels are exempt from the sales tax.

Medical Devices

Medical devices, including repair parts and accessories, are exempt from sales tax. Exempt devices include wheelchairs, crutches, artificial limbs, eyes and teeth, prescription eye glasses, hearing aids, equipment used

to administer prescription oxygen, prescription antiembolism hose and stockings, and adaptive equipment to enable a handicapped person to enter, operate and leave a motor vehicle.

Accommodations Provided by Hospitals, Nursing Homes, Nonprofit Associations and Religious Organizations

Lodging provided by hospitals, nursing homes, nonprofit organizations, and charitable and religious organizations is exempt from the sales tax. For example, all hospital room rental payments are exempt.

Meals Provided by Nursing Homes, Community-Based Residential Facilities and Hospitals, and Food Sold in Retirement Homes

Sales of meals and food by and served on the premises of hospitals, sanatoriums, nursing homes, community-based residential facilities, day care centers and retirement homes are exempt from the sales tax. Retirement homes are nonprofit residential facilities where three or more unrelated adults or their spouses have their principal residence and where support services, including meals from a common kitchen, are available to residents. Since most meals provided by these institutions are included in the daily room charge, the fiscal effect of this exemption is included in that for accommodations provided by these institutions.

EXEMPTIONS RELATED TO FARMING

Tractors and Farm Machinery

Sales of tractors and farm machinery, including accessories, attachments, fuel and parts, used directly in farming are exempt from sales tax. The exemption does not apply to motor vehicles for highway use, such as cars and trucks.

Electricity Used in Farming

Electricity sold for use in farming is exempt from the sales tax.

Fuel Used in Farming

Fuel sold for use in farming is exempt from the sales tax.

Veterinary Services and Medicines for Farm Livestock

Sales of services provided by veterinarians for animal health care, breeding or training for livestock, and of medicines used to treat farm livestock, are exempt from the sales tax.

Semen for Livestock Breeding

The sale of semen used for the artificial insemination of livestock is exempt from the sales tax.

Milkhouse Supplies

Sales of milkhouse supplies used exclusively in producing and handling milk on dairy farms are exempt from the sales tax.

EXEMPTIONS RELATED TO NONFARM BUSINESSES

Machinery and Equipment Used in Manufacturing

The sale and use of machines and processing equipment and repair parts used exclusively and directly by a manufacturer in the manufacturing process are exempt from the sales tax. Generally, manufacturing is defined as the production by machinery from existing materials of a new article with a different form, use or

name. Mobile mining and processing units, including the vehicles on which they are mounted, are also exempt manufacturing machinery and equipment.

Waste Treatment Facilities

Sales and installation of waste treatment (pollution control) facilities, replacement parts, and chemicals and supplies used in operating a waste treatment facility are exempt from the sales tax. The exemption applies to expenditures by governmental units, private industry and their construction contractors for sewage treatment plants, holding ponds and similar facilities.

Machinery and Equipment Used in Recycling

The sale and use of machinery and equipment and repair parts used exclusively and directly for waste reduction or recycling activities are exempt. Also exempt are motor vehicles used exclusively and directly in recycling that are not required to be licensed for highway use. The activities qualifying for the exemption include those that reduce the amount of solid waste generated, recover energy from solid waste, and reuse, recycle, or compost solid waste. Some recycling machinery is also exempt as manufacturing machinery.

Logging Equipment

Off-highway, heavy mechanical equipment used in the harvesting or processing of raw timber products in the field by loggers is exempt from the sales tax.

Equipment Used in the Production of Maple Syrup

The gross receipts from the sale, storage, use or other consumption of equipment used in the production of maple syrup are not subject to the sales tax.

Wood Residue Used as Fuel in a Business Activity

The sale of residue from the harvesting of timber used as a fuel in a business activity is exempt from the sales tax.

Long-Term Rental Payments for Real Estate Used for Business Purposes

Rental payments for space used for business purposes for a continuous period of more than one month are exempt from the sales tax. Real estate rentals are generally not subject to the sales tax, although the tax is imposed on rentals of hotel and motel accommodations for a period of less than one month.

Building Materials, Equipment and Supplies Used in the Construction of Professional Sports Stadiums

Sales of building materials, equipment and supplies used solely in the construction of a sports stadium built or used by a professional sports team are exempt from the sales tax. This exemption applies to the Miller Park constructed by the Southeast Wisconsin Professional Baseball Park District and to Lambeau Field constructed by the Green Bay- Brown County Professional Football Stadium District.

One-Time License or Right to Purchase Admissions to Professional Football Games

The sale by a municipality, a local professional football stadium district or a professional football team of a one-time license or similar right to purchase admission to at least three games at a football stadium in a season is exempt from the sales tax. The exemption applies to the sale of admission rights whose proceeds will be used to help finance the renovation of Lambeau Field in Green Bay.

Trucks, Tractors, Buses and Other Vehicles Sold to Common or Contract Carriers

Sales of trucks, truck tractors, buses, trailers and semi-trailers and accessories, parts and supplies sold to common or contract carriers are exempt from the sales tax. This exemption applies to urban mass transportation, bus and trucking companies, and other contract carriers.

Commercial Vessels and Barges

Sales, storage, use or other consumption of commercial vessels and barges in excess of 50 tons and primarily engaged in interstate or foreign commerce or commercial fishing are exempt from the sales tax. Accessories, parts and fuel for these vessels are also exempt from the tax.

Rolling Stock Used in Railroad Operations

Sales of all rolling stock or accessories, attachments and fuel and lubricants used in railroad operations are exempt from the sales tax. Rolling stock includes items such as rail freight cars and locomotives.

Motion Picture and TV Film and Advertising Materials

The sale, lease or rental, or storage, use or other consumption of motion picture films and of advertising material sold, leased or rented to movie theaters or radio or television stations is exempt from the sales tax.

Restaurant Employee Meals

Meals that are provided by a restaurant to the restaurant's employee during the employee's work hours are exempt from the sales tax.

Tangible Personal Property Purchased for Resale but Donated to a Nonprofit Organization

Property purchased tax-free for resale or under a valid exemption certificate and later donated to a nonprofit organization is exempt from the use tax.

Prepaid Telephone Cards and Authorization Numbers

Services obtained by the use of a prepaid telephone card or authorization number are exempt from sales tax if sales tax was paid on the card or authorization number at the time it was purchased.

EXEMPTIONS FOR GOVERNMENT AGENCIES AND NONPROFIT ORGANIZATIONS**Sales to the Federal Government and Its Agencies**

Sales of goods and services to the federal government or to any of its incorporated or unincorporated agencies or instrumentalities are exempt from the sales tax. Taxing purchases by the federal government would violate the U. S. Constitution, so the fiscal effect of this exemption has not been estimated.

Sales to State and Local Governments and Schools

The gross receipts from sales to, and the storage, use or other consumption of tangible personal property and taxable services by state, county, city, village and town governments, school districts, local exposition districts, local cultural arts district, local water authority and metropolitan sewerage districts are exempt from the sales tax.

Volunteer Fire Department Equipment

Sales of fire trucks and other fire-fighting equipment to volunteer fire departments are exempt from the sales tax. This exemption also applies to hoses, exhaust fans, generators, ladders and similar equipment.

Motor Vehicles Loaned To Driver Education Programs

The loan by an automobile dealer of a motor vehicle for a driver education program conducted by a school or school district is exempt from the use tax.

Religious, Charitable, Scientific and Educational Organizations

The gross receipts from sales to, and the storage, use or other consumption of tangible personal property and taxable services by any corporation, community chest, foundation or association organized and operated exclusively for religious, charitable, scientific or educational purposes are exempt from the sales tax.

Snowmobile Trail Grooming Equipment

Snowmobile trail groomers and attachments are exempt from the sales tax when purchased by snowmobile clubs for use in maintaining the state system of snowmobile trails. To qualify for the exemption, an organization must meet at least three times a year and have at least 20 members.

Charges for Emergency Telephone Systems

Charges levied by a county or group of counties to finance an emergency telephone system ("911" system) are exempt from the sales tax.

Admissions to Elementary and Secondary School Activities

Sales of tickets or admissions to public and private elementary and secondary school activities are exempt from the sales tax, if the net proceeds are used for educational, religious or charitable purposes. For example, revenue from admission fees to high school sporting events, school plays and other school activities are exempt from the sales tax.

Hot Lunches and Other Tangible Personal Property Sold by Elementary and Secondary Schools

Sales of tangible personal property by either public or private elementary and secondary schools are exempt from the sales tax. School lunches account for over 90% of these sales.

Copies of Public Records

Copies of public records, including fees for searches, are exempt from the sales tax.

Sales of Animal Identification Tags and Samples by the Department of Agriculture, Trade and Consumer Protection

Sales by the Wisconsin Department of Agriculture, Trade and Consumer Protection of animal identification tags to persons who are required or authorized to use those identification tags, and sales of standard samples representing product or commodity grades are exempt from the sales tax.

State Park Admission Fees and Camping Fees

Admission fees and camping fees at state park and state forest recreational areas are exempt from the sales tax.

Admissions to Certain Historical Museums

Admissions to a museum operated by a nonprofit corporation under a lease agreement with the State Historical Society are exempt from the sales tax. This exemption applies only to the Circus World Museum in Baraboo.

Admissions to County Fairs

Admissions to county fairs are exempt from the sales tax.

Sales by American Legion Baseball Teams

Sales of tangible personal property, tickets and admissions by American Legion baseball teams are exempt from the sales tax.

EXEMPTIONS FOR NONRESIDENTS AND FOR USE IN OTHER STATES**Interstate Commerce**

Tangible personal property shipped in interstate commerce is not subject to the sales tax. The fiscal effect of this exemption has not been estimated because taxing such property is prohibited by the U.S. Constitution.

Property Used in the State by Nonresidents

Tangible personal property brought into the state by nonresidents of Wisconsin for their own use, storage, or other consumption while temporarily in Wisconsin is exempt from the use tax. However, if the property is used to conduct a trade, business or profession, or used in the performance of personal services for wages or fees, the property is subject to the tax.

Nonresidents' Boats Berthed in Boundary Waters

Generally, a boat that is owned by a resident of another state and berthed in Wisconsin is subject to use tax, if the owner did not pay sales tax when purchasing the boat. However, the boat is exempt from use tax if: (1) the boat owner is a resident of a state contiguous to Wisconsin, (2) the boat is berthed in boundary waters adjacent to the owner's state of residence, and (3) the purchase of the boat was an exempt occasional sale.

Nonresidents' Aircraft Hangared in Wisconsin

Aircraft purchased in another state by a nonresident individual or business and kept in a hangar in Wisconsin is exempt from use tax.

Goods Brought into the State by New Residents

Household goods purchased outside of Wisconsin but brought into the state by new residents are exempt from use tax if the goods are purchased 90 or more days prior to the date the person moves to Wisconsin. This exemption applies to all household goods, including automobiles and other registered vehicles, purchased for personal use.

Property Purchased for Use Outside the State

Sales of tangible personal property purchased for use outside the state and sales of property delivered and prepared for export are exempt from the sales tax. For example, items such as office supplies and paper products sold to persons outside the state are exempt from the sales tax.

Aircraft, Motor Vehicles and Truck Bodies Sold for Use Outside the State

Sales of aircraft, motor vehicles and truck bodies to nonresidents who will not use such units in Wisconsin are exempt from the sales tax. This exemption also applies to aircraft, motor vehicles and truck bodies sold to certified carriers of people or property in interstate or foreign commerce and foreign governments.

Property Sold to Out-of-State Common or Contract Carriers

Sales of tangible personal property to common or contract carriers engaged primarily in trucking and to railroad companies are exempt from the sales tax, if the property is shipped to a destination outside this state. Wisconsin, for example, is a major producer of railroad ties, and all shipments of railroad ties out of state are exempt from the sales tax.

Printed Advertising Material Used Outside the State

Sales of printed advertising materials produced in Wisconsin and sold to purchasers for use only outside the state are exempt from the sales tax. For example, advertising leaflets, which are printed and purchased in the state but distributed only in a neighboring state, would not be subject to the sales tax.

Temporary Storage of Printed Materials

The temporary storage of raw materials that are incorporated into printed materials to be transported outside Wisconsin, and thereafter used solely outside Wisconsin, are exempt from sales and use tax. An example of printed materials qualifying for the exemption would be paper purchased by a company from an out-of-state vendor and delivered to a Wisconsin printer that prints catalogs for the purchaser, if the catalogs are distributed only outside Wisconsin.

DEFINITIONAL AND MISCELLANEOUS EXEMPTIONS**Exemptions That Further Define Retail Sales**

The purpose of this exemption report is to estimate the cost to the state of providing specific exemptions to the sales tax for items that would otherwise be taxable. By law, retail sales are subject to the sales tax, unless otherwise stated. A retail sale is defined as one where the buyer makes a purchase with no intention of resale. However, in the statutes, certain sections clarify the definition of a retail sale, even though they read as exemptions. For these sections no fiscal estimates have been made because sales of these items are not retail sales.

The following transactions fall into this category:

- Tangible personal property that is consumed, destroyed or loses its identity in the manufacturing process of finished goods. Section 77.54 (2), Wis. Stats.
- Materials and services that become a component part of shoppers guides, newspapers and periodicals. Section 77.54 (2m), Wis. Stats.
- Tangible personal property used exclusively in farming when the user is engaged in farming as a business enterprise; examples include feed for livestock, seed and fertilizer. Section 77.54 (3m), Wis. Stats.
- All fuels converted to electric energy, gas or steam by utilities. Section 77.54 (6) (c), Wis. Stats.
- Packaging materials used by the purchaser to transfer merchandise to customers and all meat-packaging materials, regardless of whether such items are used to transfer merchandise to customers. Section 77.54 (6) (b), Wis. Stats.
- Charges for interest, financing or insurance when such charges are stated separately. Section 77.54 (8), Wis. Stats.
- Transfer of property to a corporation upon its organization solely in consideration for the issuance of its stock. Section 77.51 (14g) (a), Wis. Stats.
- Contributions of property to a newly-formed partnership solely in consideration for a partnership interest. Section 77.51 (14g) (b), Wis. Stats.

- Contributions of property to a limited liability company upon its organization solely in consideration for a membership interest. Section 77.51 (14g) (bm), Wis. Stats.
- Transfer of property to a corporation for the issuance of its stock pursuant to a merger or consolidation. Section 77.51 (14g) (c), Wis. Stats.
- Transfer of property to a limited liability company for a membership interest pursuant to a merger. Section 77.51 (14g) (cm), Wis. Stats.
- Distribution of property by a corporation to its stockholders as a dividend or in liquidation. Section 77.51 (14g) (d), Wis. Stats.
- Distribution of property by a partnership to its partners in liquidation. Section 77.51 (14g) (e), Wis. Stats.
- Distribution of property by a limited liability company to its members in liquidation. Section 77.51 (14g) (em), Wis. Stats.
- Repossession of property when the only consideration is cancellation of the purchaser's obligation to pay the balance of the purchase price. Section 77.51 (14g) (f), Wis. Stats.
- Transfers of property in a reorganization in which no gain or loss is recognized for Wisconsin franchise or income tax purposes under sections 71.301 to 71.368, Wis. Stats. Section 77.51 (14g) (g), Wis. Stats.
- Accounts that are found to be worthless, uncollectible and charged off for income tax purposes. Sections 77.51 (4) (b)4 and 77.52 (6), Wis. Stats.
- The portion of a sales price that is either refunded in cash or credit as a result of property returned. Section 77.51 (4) (b)2, Wis. Stats.
- The transfer of electric transmission facilities to a transmission company. Section 77.51 (14g) (fm), Wis. Stats.

Labor Input into Construction

Materials used in construction are subject to the sales tax; however, the value added by construction contractors is not taxed. Construction is a volatile sector of the economy and, as a result, the cost of this exemption fluctuates from year to year.

Trade-Ins

In transactions in which a product is traded in on the purchase of a product of greater value, the sales tax is applied only to the difference between the values of the two products. The estimate applies only to trade-ins of automobiles and trucks; it does not include trade-ins of boats, mobile homes, household appliances or other items.

Transportation Charges

Transportation charges are exempt from the sales tax if the charges are stated separately, and if the transportation occurs after the purchaser takes possession of the property.

Occasional Sales

Occasional sales are sales by persons other than those offering goods for sale in the ordinary course of business. Taxable occasional sales include sales of automobiles, aircraft, trailers, semi-trailers, snowmobiles, all-terrain vehicles, and mobile homes not exceeding 45 feet in length, registered in the state, and boats registered in the state or in the U. S. However, these occasional sales are exempt if the transfer is to a spouse, parent or child, or the spouse of a parent or child, and if the item had previously been registered in Wisconsin, or in the case of boats, registered in the state or in the U. S. Also, the transfer of a motor vehicle from an individual to a corporation solely owned by that individual is exempt. All other occasional sales are exempt from sales tax.

Auction Sales

Gross receipts from auctions of farm personal property or household goods that are not held at regular intervals are exempt from the sales tax.

Retailer's Discount

Retailers may retain 0.5% of their tax liability or a minimum of \$10 per filing period as compensation for the costs of collecting and remitting sales taxes.

SERVICES NOT SUBJECT TO TAX

Services are exempt from sales tax unless the statutes specifically impose the tax. An estimate of the total cost of not taxing services is not possible with the data available. However, the following table shows major services that are not subject to sales tax and provides an estimate of the potential fiscal effect. The table does not include services that are specifically exempted from tax by the statutes and discussed in previous sections, such as coin-operated laundry services, diaper services, veterinary services for farm animals and labor services in construction.

TABLE 4
SALES AND USE TAX EXEMPTIONS-SERVICES

| Exemption | FY02 Fiscal Effect |
|---|--------------------|
| Personal and Recreational Services | |
| Beauty, Barber, Nail and Other Personal Care Services | \$22,600,000 |
| Funeral Services | 10,600,000 |
| Bank Account Service Charges | 19,900,000 |
| Dues and Fees Paid to Business Associations and Fraternal Organizations | 12,500,000 |
| Live Bands and Orchestras | 200,000 |
| Health Clubs | 1,900,000 |
| Admissions to Educational Events and Places | 5,400,000 |
| Veterinary Services for Pets | 12,600,000 |
| Dance Studios | 700,000 |
| Auto and Travel Clubs | 1,900,000 |

TABLE 4
SALES AND USE TAX EXEMPTIONS-SERVICES (continued)

| Exemption | FY02 Fiscal Effect |
|---|--------------------|
| Professional Services | |
| Services of Physicians, Dentists and Other Health Professionals | 320,000,000 |
| Legal Services | 87,000,000 |
| Architectural, Engineering and Surveying Services | 63,000,000 |
| Accounting Services | 50,000,000 |
| Tax Preparation Services | 3,300,000 |
| Business Services | |
| Advertising | 108,800,000 |
| Computer Services (inc. data processing and custom programming) | 151,000,000 |
| Management Consulting and Public Relations | 50,000,000 |
| Personnel Services | 53,000,000 |
| Addressing and Mailing | 8,600,000 |
| Credit Rating and Collection Services | 7,300,000 |
| Protective Services | 13,000,000 |
| Research, Development and Testing Services | 26,000,000 |
| Services Related to Real Property | |
| Commissions to Real Estate Brokers | 46,000,000 |
| Repair of Real Property | 25,000,000 |
| Interior Design | 3,000,000 |
| Janitorial Services | 23,000,000 |
| Disinfecting and Exterminating | 2,300,000 |
| Sewerage Services | 21,300,000 |

INSURANCE PREMIUM TAXES

Introduction

Chapter 76 of the Wisconsin Statutes provides for the taxation of certain insurance companies by the Commissioner of Insurance on the basis of premiums or net investment income. Insurance business subject to taxation under Chapter 76, Wis. Stats., is not subject to the corporate income and franchise tax under Chapter 71, Wis. Stats., and vice versa. Some types of insurance companies are not subject to taxation under either chapter.

The tax imposed by Chapter 76, Wis. Stats., may apply to all insurance companies, foreign (companies organized outside Wisconsin) as well as domestic (organized in Wisconsin). The corporate franchise tax applies to domestic fire and casualty insurers and the nonlife business of domestic life insurers.

Insurers exempt from taxation under both Chapters 71 and 76, Wis. Stats., include: fraternal or mutual benefit societies; town mutual insurance companies (except that fire dues are payable equal to 2% of the fire premiums); voluntary benefit plans for injury or death of students; self-insurers (except that fire dues are payable equal to 2% of the premiums that would have been charged by authorized insurers); the State Property Insurance Fund (except for fire dues on nonstate-owned property); and the Wisconsin Health Care Liability Plan and Patients Compensation Fund.

Insurance companies subject to the corporate income and franchise tax are subject to the same tax rate as that imposed on all other corporations subject to the tax, except that the tax is limited to 2% of premiums. The tax rates for insurance companies subject to taxation under Chapter 76, Wis. Stats., vary depending on the type of insurance business. In addition, because of the "reciprocal and retaliatory" statutes, Wisconsin taxation of foreign insurance companies (companies organized outside the state) is dependent on the taxation of Wisconsin-organized insurance companies in the domicile of such foreign companies. For example, the Wisconsin taxation of a New York company doing business in Wisconsin is dependent on the New York taxation of a Wisconsin company doing business in New York.

The Wisconsin "retaliatory" statute provides, in essence, that when the taxes/fees imposed by another state or country on insurers organized under Wisconsin laws doing business in that state or country are greater than the taxes or fees imposed by Wisconsin on those foreign insurers doing business in Wisconsin, then Wisconsin will tax insurers organized under the laws of the other state or country at the same higher rate.

The Wisconsin "reciprocal" statute provides that insurers organized under the laws of other states, territories or districts of the United States (but not other countries) shall not pay taxes, fees or licenses to Wisconsin greater than the taxes, fees or licenses imposed by the other state, territory or district on similar Wisconsin insurers doing business there. The reciprocal statute does not result in pure reciprocity because it does not apply to insurance companies organized in other countries, and it does not permit payment of less than the Wisconsin statutory tax on life insurance, fire dues (2% fire department dues) and certain fees. In addition, it requires a minimum tax of 0.375% on fire and ocean marine premiums.

Because some Wisconsin companies do insurance business in all other states, territories or districts of the United States, the effect of the reciprocity and retaliation statutes is that few U. S. fire or casualty insurers are taxed at the rates provided in the Wisconsin Statutes (except the 0.375% minimum tax on fire and ocean marine premiums). In general, the "retaliatory" statutes applicable to insurers organized in other countries cannot be applied because of limitations imposed by international treaties between the United States and the insurer's domiciliary country, or because of practical problems of application or computation. Thus, non-U. S. insurers are taxed at the Wisconsin statutory rate. The statutory rates are as follows: fire, 2.375%; ocean marine, 0.5%; casualty, 2%; domestic life (over \$750 million in force), 2%; domestic life (\$750 million or less in force), 3.5% of gross income (this tax plus a valuation fee is subject to a maximum of 2% of net taxable premiums); nondomestic life, 2%; and nondomestic accident and health, 2%.

For the premium tax, the base is gross premiums received for direct insurance less return premiums and cancellations and policyholder dividends from savings and gains on direct insurance in Wisconsin. Direct insurance includes all insurance other than reinsurance. Under reinsurance, an insurer shares the risk and premiums with other insurers.

General purpose tax collections from the insurance premiums taxes in FY 2002 were \$96 million. This excludes \$11.3 million of fire department dues which, beginning in FY82, were changed from general purpose to program revenue. Fire department dues are distributed to local units of government, while other insurance company taxes are part of the state general fund.

| Insurance Premium Taxes Summary | | |
|---|--------------------------------|--------------------|
| Exemption Device | Statutory Reference* | FY02 Fiscal Effect |
| Exemptions from Taxation | | |
| Town Mutual Insurance Companies | s. 76.61 | \$1,077,000 |
| Domestic Fire, Marine and Casualty Companies | ss. 76.60 and 76.63 (1) | \$146,910,000 |
| Fraternal Life Insurance Companies | s. 76.65 | \$4,282,000 |
| Exemptions From Base | | |
| Return Premiums and Cancellations on Direct Insurance | ss. 76.60, 76.62 and 76.63 (1) | ** |
| Exemptions from the Domestic Life Insurance Company Gross Income Tax Base | s. 76.65 (1) | \$94,000 |
| Exemptions from the Foreign and Domestic Life Insurance Company Gross Premium Tax Base | s. 76.65 (2) | \$1,060,000*** |
| Special Treatment | | |
| Limit on Gross Income Tax of Domestic Life Insurance Companies with \$750 Million or Less of Insurance in Force | s. 76.65 (1) | None |
| "Retaliatory" Statute | s. 76.66 | Not Available |
| "Reciprocity" Statute | s. 76.67 | \$30,740,000 |
| Credits | | |
| Credit to Domestic Life Insurers for Personal Property Taxes | s. 76.69 | \$562,000 |
| Credit to Insurers to Recoup Security Fund Assessments | s. 646.51 (7) | \$2,175,000 |
| Credit to Insurers for Certified Capital Investment | s. 76.635 (2) | \$4,250,000 |

*References to sections of the 2001 Wisconsin Statutes.

**Included in estimates for exemption for domestic, fire, marine and casualty companies and for "reciprocity" statute.

***Fiscal effect for domestic insurers only. Fiscal effect for foreign corporations included in the estimate for "reciprocity" statute.

EXEMPTIONS FROM TAXATION

Town Mutual Insurance Companies

Town mutual insurance companies organized under or subject to Chapter 612 of the Wisconsin Statutes are not subject to taxation or license fees under Chapter 76, Wis. Stats. They are subject, however, to a fire dues tax of 2% of direct fire premiums. A town mutual insurance corporation may be organized by at least 100 adults, each of whom has a separate insurable risk within a prescribed territory. The territory may not exceed eight contiguous counties; however, the Commissioner of Insurance may allow a broader territory not larger than sixteen contiguous counties. A town mutual may insure members against loss or damage from any cause to any property in which a member has an interest, including insurance against loss of use or loss of income from property. The insurance of crops and other property against loss due to windstorm or hail are restricted and must be reinsured. Town mutual insurers may insure policy

holders from liability, errors and omissions and medical payments and other supplemental coverage when reinsured.

Domestic Fire, Marine and Casualty Companies

Wisconsin-organized insurance companies insuring fire, marine and casualty risks are not subject to Wisconsin premium taxation with the exception of mortgage guaranty insurers. Companies not subject to the premiums tax are subject to the corporation franchise tax. They are subject to a fire dues tax of 2% of direct fire premiums written. Casualty risks also include all lines of accident and health insurance written by life companies, fraternal insurers, health maintenance organizations, limited service health organizations, and health medical dental indemnity insurers.

Fraternal Life Insurance Companies

All corporations transacting life insurance business in Wisconsin are subject to taxation under Chapter 76, Wis. Stats., except fraternal insurers organized and operating under Chapter 614 of the Wisconsin Statutes. A fraternal insurer must have a lodge system and a representative form of government. It must exist solely for the benefit of its members and their beneficiaries and solely for any lawful social, intellectual, educational, charitable, benevolent, moral, fraternal, patriotic or religious purposes for the benefit of its members or the public, carried on through voluntary activity of its members in their local lodges or through institutional programs of the fraternal or its lodges. It may carry only life and accident and health lines of insurance.

EXEMPTIONS FROM BASE

Return Premiums and Cancellations on Direct Insurance

For the tax on fire, marine and casualty insurance premiums, the tax base is defined as gross premiums as calculated under section 76.62, Wis. Stats. This section provides that all license fees and taxes levied under any provision of law upon gross premiums other than life insurance premiums shall be based on gross premiums received for direct insurance, less return premiums and cancellations, and returns from savings and gains on all insurance, other than reinsurance by the insurer during the preceding year in this state.

Reinsurance, whereby one insurer shares a portion of the premium in return for a sharing of a portion of the risk with another insurer, is not subject to taxation unless the original insurer fails to pay the premiums tax. The fiscal effect of this exemption for domestic companies is included in the exemption from taxation for domestic fire, marine and casualty companies; for foreign companies, it is included in the estimate for the "reciprocity" statute.

Exemptions from the Domestic Life Insurance Company Gross Income Tax Base

The tax base for domestic (Wisconsin organized) life insurance companies (which may affect only those companies with \$750 million or less of insurance in force) is gross income from all sources, except:

1. interest required to provide and maintain reserves according to the laws of Wisconsin, and
2. premiums collected on policies of insurance and contracts for annuities.

The gross income, net of the above deductions, is subject to a factor with the numerator being net investment income applicable to life insurance and annuities and the denominator being total net investment income.

Exemptions from the Foreign and Domestic Life Insurance Company Gross Premium Tax Base

The tax base for foreign life insurance companies, which is also applicable to domestic life insurance companies having more than \$750 million of insurance in force and may affect those with \$750 million or less of insurance in force, is gross premiums on all policies or contracts of insurance on the lives of residents of Wisconsin less all sums apportioned to premium-paying policies on the lives of residents of Wisconsin from annual distributions of profits, savings, earnings or surplus that have been either paid in

cash or applied in partial payment of premiums. Because of long-standing administrative construction, considerations received for annuity contracts are not considered premiums on policies or contracts of insurance and, thus, are not taxable under section 76.65 (2), Wis. Stats. The fiscal effect shown is that for domestic insurers; the fiscal effect for foreign companies is included in the estimate for the "reciprocity" statute.

SPECIAL TREATMENT

Limit on Gross Income Tax of Domestic Life Insurance Companies with \$750 Million or Less of Insurance in Force

For domestic life insurance companies with \$750 million or less of insurance in force, the tax based on 3.5% of gross income (less deductions) cannot exceed the annual license fee that would have been payable had it been operating as a foreign company (in which case the tax would be 2% of gross premiums, after deducting the preceding tax exemption device). This limit had no fiscal effect in FY02.

"Retaliatory" Statute

The Wisconsin "retaliatory" statute may result in an increase in Wisconsin fees, thus it might not be considered a tax exemption device. However, to the extent that the statutes of other states provide tax exemption devices for insurance companies organized in Wisconsin doing business in such states, the Wisconsin "retaliatory" statute could also allow such tax exemption devices to insurance companies doing business in Wisconsin. The fiscal effect of these other states' statutes are included in the estimate for the "reciprocity" statute.

"Reciprocity" Statute

To the extent that insurance companies organized in Wisconsin operating in the United States outside Wisconsin are subject to taxation to a lesser extent than otherwise provided by Wisconsin law, the Wisconsin "reciprocity" statute may provide reduced taxation for non-Wisconsin companies organized in the United States for business transacted in Wisconsin. The limitations of the "reciprocity" statute are described in the introduction.

CREDITS

Credit to Domestic Life Insurers for Personal Property Taxes

Domestic life insurance companies are allowed a premiums tax credit of 50% of general property taxes paid on personal property in Wisconsin used in the operation of business and not held primarily for investment purposes. The credit is limited to 25% of the license fee for domestic life insurers.

Credit to Insurers to Recoup Security Fund Assessments

The Insurance Security Fund Board administers the security fund established by Chapter 646, Wis. Stats., to provide a mechanism for protecting insureds in the event of liquidation of insurers and to assess the costs of such protection among insurers. Section 646.51 (7), Wis. Stats., provides for tax credits of 20% of security fund assessments in each of the five calendar years following the year the assessment was paid when premium rates are fixed so that it is not possible for the insurer to increase its premium rates to recoup the assessment. Domestic insurers may take tax credits only for the proportion of their business assessed which is fixed, such that it is impossible to raise premiums. Such policies are referred to as "noncancellable" in the insurance business and represent a small portion of the total insurance written. Nondomestic insurers may take tax credits subject to the provision of the retaliatory and reciprocal statutes (sections 76.66 and 76.67, Wis. Stats.)

Credit to Insurers for Certified Capital Investment

Since FY99 certain insurers operating in Wisconsin are allowed to take a premium tax credit for investment in certified capital companies as defined in s. 560.30 Wis. Stats. The purpose of the credit is

to encourage insurers to make venture capital for companies operating in Wisconsin. Section 76.635 (2) Wis. Stats. provides for tax credits of up to 10% of the amount of the certified investment each year, until the entire available credit is used.

PROPERTY TAX

Many owners of exempt real property are required to report its estimated fair market value as of January 1 of each even-numbered year. The Department of Revenue (DOR) is required to tabulate the data filed by owners and estimate the total value of tax exempt real property by category of owner for inclusion in this publication.

Exceptions from the reporting requirement are pollution treatment plant and abatement equipment, manufacturing machinery and equipment, crops, manure storage facilities, secondary containment structures, certain housing authority property, cemeteries, and archaeological sites. In addition, legislation enacted in 1996 repealed the reporting requirement for the state, municipalities, school districts, and certain special purpose districts. Also, the value of federal property is not reported. Thus, the report focuses on exempt private real property.

Property Tax Exemption Value Data

The "Taxation District Exemption Summary Report" on page 74 summarizes data for the municipalities that filed Taxation District Exemption Summary Reports with DOR by August 1, 2002. Of the total of 1,900 taxation districts, 370 had not filed as of that date.

To develop total values for each purpose of property, the number of parcels in each value cell for that purpose is multiplied by the midpoint of the range of values for that cell, and the results summed. Thus, for the "place of worship" classification, the 234 parcels in the \$1 to \$10,000 range multiplied by \$5,000 is added to the 1,120 parcels in the \$10,001 to \$100,000 range multiplied by \$55,000, and so on for each value category and each purpose of property classification. Based on this aggregation, the value of the 18,220 exempt parcels in the summary report is \$16 billion.

An adjustment was made for the 370 municipalities which had not filed as follows. First, the total taxable value of the towns among the 370 non-filers was determined. This value was multiplied by 2.3%, which is the percent of total taxable property reported by the filing towns to be exempt. Similar computations were made for the villages and cities among the 370 non-filers. The average exemption rate for villages was 5.4%; for cities it was 9.2%. Based on this approach, the value of exempt real property in the 370 non-filing municipalities was estimated to be \$2.6 billion which, when added to the \$16 billion for the municipalities that filed, produced a total of \$18.6 billion.

Table 1 shows the percentage of total exempt property by purpose for 2002, and the estimated value of that property. The percentages, which are based on the reports filed by taxation districts, are used to allocate the estimated \$18.6 billion in exempt property by purpose.

The table shows that, of the estimated \$18.6 billion of exempt private property, "place of worship" is the largest category with about 33% of the total, or \$6,159 million. "Non-profit hospitals" is the second largest category with 11.7% or about \$2,172 million. "Public benefit" is the third largest category with 10% or \$1,849 million in exempt property. This category includes the properties of YMCAs, YWCAs, Scouts, Boys' Clubs, and many other minor categories of exempt property. "Educational, K-12" and "Private Colleges" comprise 8.2% and 8.3% respectively of exempt property, equal to a combined \$3,085 million.

TABLE 1
ESTIMATED VALUE OF EXEMPT PRIVATE REAL PROPERTY, 2002

| Purpose of Property | Percent of Total | Exempt Value (\$ millions) |
|--------------------------------------|------------------|-------------------------------|
| CHURCH/RELIGIOUS: | | |
| Place of Worship | 33.1 % | \$6,159 |
| Church—Other | 5.0% | \$932 |
| SUBTOTAL CHURCH/RELIGIOUS | 38.1% | \$7,091 |
| HOUSING: | | |
| Nursing Home, incl. religious | 5.3% | \$993 |
| Retirement Home, incl. religious | 4.3% | \$790 |
| Housing—Other | 4.6% | \$862 |
| SUBTOTAL HOUSING | 14.2% | \$2,645 |
| EDUCATIONAL, INCL. RELIGIOUS: | | |
| Grades K-12 | 8.2% | \$1,528 |
| Private College | 8.3% | \$1,557 |
| Other—Educational | 3.4% | \$628 |
| SUBTOTAL EDUCATIONAL | 19.9% | \$3,713 |
| MEDICAL FACILITY: | | |
| Non-profit Hospital, incl. religious | 11.7% | \$2,172 |
| Medical Research Foundation | .4% | \$73 |
| Medical—Other | 1.1% | \$196 |
| SUBTOTAL MEDICAL FACILITY | 13.2% | \$2,441 |
| PUBLIC BENEFIT | 10.2% | \$1,849 |
| OTHER | 4.6% | \$847 |
| TOTAL | 100.0% | \$18,586 |

Note: Columns may not sum to totals due to rounding.

Effect of Exempt Property on Tax Rates

It is often argued that property tax rates can be reduced by repealing exemptions. Table 2 explores this hypothesis. The table shows the actual 2001 average net property tax rates for towns, villages, cities, and statewide, as well as tax rates calculated under the assumption that the estimated \$18.6 billion of exempt private real property reported in Table 1 is added to the tax rolls. The analysis assumes that there would be no change in the overall level of state and federal aids and no change in total property tax levies.

Table 2 indicates that, if the reported exempt private real property had been placed on the tax roll in 2001, the statewide average net property tax rate would have declined by 5.6% from \$21.03 to \$19.86 per \$1,000 of value. Under this scenario, total net tax rates in cities, villages, and towns would have been lower by 8.4%, 5.1%, and 2.2%, respectively.

The larger impact in cities and villages reflects the fact that exempt public property—schools, hospitals, public housing—is more likely to be located in urban municipalities than in rural areas. As noted earlier, exempt private real property averages 9.3% of the value of total taxable property in cities, 5.4% in villages, and 2.3% in towns.

TABLE 2
AVERAGE NET TAX RATES FOR 2001, COLLECTED IN 2002 (\$ PER \$1,000 VALUE)

| For Property In: | Actual Rate | Rate If Exempt Private Real Property Was Taxable | Percentage Change |
|-------------------|-------------|--|-------------------|
| Cities | \$23.84 | \$21.85 | -8.4% |
| Villages | \$21.70 | \$20.59 | -5.1% |
| Towns | \$17.34 | \$16.96 | -2.2% |
| Statewide Average | \$21.03 | \$19.86 | -5.6% |

Evaluation

A number of limitations to the estimates presented should be noted. First, the reported data are incomplete because reports from 370 taxation districts had not been received by the time the report was prepared, and the value of exempt property in these districts had to be estimated.¹ Also, the value of exempt machinery and equipment, inventories, computers and pollution treatment plant and abatement equipment.² In addition, the value of exempt federal, state, and local government property is not included in this report.

Second, there may be systematic underestimation of exempt property values reported for at least two reasons: (a) a lack of knowledge of the value of often highly-specialized property, which has not been on the market in many years and which is not likely to be offered for sale in the foreseeable future, and (b) a desire to minimize the perceived benefit of the tax exemption for political reasons. However, the data were not audited and, therefore, underestimation cannot be confirmed.

Due to the limitations of these data, care should be taken in using them to represent exempt property values. Care should also be taken in comparing these data to prior years' reports due to the changes in 1996 in reporting requirements and reporting forms.

¹ The 370 municipalities were comprised of 285 towns, 65 villages and 20 cities.

² It is estimated that approximately \$12.5 billion of machinery and equipment, \$100 million in waste treatment property, and \$74 million in computer equipment are currently exempt from tax. No estimates are available regarding the value of exempt inventory.

TAXATION DISTRICT EXEMPTION SUMMARY REPORT FOR 2002 (S. 70.337(2), Wis. Stats.)

See instructions on bottom of form.

CO _____ MUN _____ FOR _____ OF _____ T-V-C _____ NAME OF TAXATION DISTRICT _____ NAME OF COUNTY _____

| INDICATE NUMBER OF PROPERTIES BY PURPOSE OF PROPERTY WITHIN EACH VALUE CATEGORY | | | | | | | | | | |
|---|-------------------|-------------------------|--------------------------|--------------------------|--------------------------|----------------------------|------------------------------|------------------------------|-------------------------------|-------------------------|
| PURPOSE OF PROPERTY | 1 \$1-\$10,000 | 2 \$10,001-\$100,000 | 3 \$100,001-\$150,001 | 4 \$150,001-\$200,001 | 5 \$200,001-\$500,000 | 6 \$500,001-\$1,000,000 | 7 \$1,000,001-\$3,000,001 | 8 \$3,000,001-\$6,000,000 | 9 \$6,000,001-\$12,000,000 | 10 Over \$25,000,000 |
| WORKSHIP | 234 | 1,120 | 880 | 1,153 | 881 | 931 | 185 | 48 | 9 | 19 |
| CHURCH-OTH | 564 | 1,218 | 526 | 187 | 100 | 76 | 15 | 7 | 4 | 4 |
| EDU, K-12 | 62 | 162 | 57 | 124 | 102 | 158 | 53 | 24 | 13 | 4 |
| COLLEGE | 27 | 107 | 55 | 34 | 19 | 27 | 34 | 20 | 12 | 17 |
| EDU-OTH | 84 | 223 | 84 | 112 | 62 | 54 | 12 | 8 | 2 | 4 |
| HOSPITAL | 12 | 72 | 55 | 24 | 17 | 24 | 15 | 23 | 29 | 24 |
| MED RSCH | 1 | 6 | 1 | 3 | 2 | 3 | 1 | 1 | 0 | 1 |
| MED-OTH | 24 | 162 | 24 | 24 | 16 | 20 | 6 | 1 | 1 | 1 |
| NURSING | 17 | 11 | 9 | 5 | 12 | 29 | 25 | 23 | 16 | 4 |
| RETIRE | 3 | 41 | 45 | 31 | 30 | 66 | 30 | 17 | 5 | 3 |
| HOUSE-OTH | 93 | 857 | 668 | 215 | 105 | 71 | 25 | 2 | 3 | 3 |
| BENEFIT | 445 | 1,051 | 296 | 268 | 145 | 145 | 50 | 13 | 3 | 15 |
| OTHER | 1,026 | 1,160 | 273 | 186 | 76 | 64 | 10 | 4 | 3 | 6 |
| TOTAL NO. OF PROPERTIES | 2,565 | 6,190 | 2,973 | 2,366 | 1,569 | 1,570 | 461 | 191 | 100 | 105 |

NAME OF CLERK (please print) _____ TELEPHONE NUMBER () _____

INSTRUCTIONS

Enter the number of exempt properties in your municipality in each value range by purpose or use of property. You can gather this information from the PC-220 forms which are filed by the property owner. A parcel with more than 1 building and more than 1 use should be recorded for each use. Example: For a parcel with a church valued at \$500,000 and a parsonage valued at \$150,000 enter 1 property in the 1st value category under WORSHIP and enter 1 property in the 11th value category under HOUSE-OTH.

Enter the total number of properties by organization category in the right hand column.

Enter the total number of properties within each value range in the total line at the bottom.

Enter the name and telephone number of the person completing this form.

P-C 228 (R. 3-01)

Note: You should send form PC-227 to organizations reporting to be subject to taxation under sections 511 to 515 of the IRC (see s. 70.339, Wis. Stats.).

Complete and mail this form by July 1 to:

Wisconsin Department of Revenue
Bureau of Local Financial Assistance
P. O. Box 8033
Madison, WI 53708-8033

FOREST CROP AND MANAGED FOREST LAWS

The Forest Crop and Managed Forest Laws extend special property tax treatment to owners of qualifying forest land. The Forest Crop Law was enacted in 1927 as a means of promoting private forestry in the state. The law was closed to new entrants when the Managed Forest Law went into effect in 1986.

Historical Background

In the early 1900s, Wisconsin was a major timber producer. By the 1920s, much of the state's forest land had been cut-over or damaged by fire. Private forestry faced a grim future, leading owners of cut-over or burned forest land holding on to their land in the hope it could be sold for farming. However, the precipitous drop in farm commodity prices following the end of World War I caused a dramatic fall in the both farm income and farm land prices. Lacking a market for their land, forest land owners proved unwilling or unable to pay their property taxes. At tax sales, few buyers came forward to redeem the land, obliging the counties to assume ownership. Over time, as more and more owners abandoned their land, local governments faced a fiscal crisis.

From an economic standpoint, while property taxes on farm land are paid from the proceeds of annual crops, property taxes on forest land are levied annually on the value of the land and trees even though no harvest may occur for many years. It was thought that relieving forest land owners of the burden of annual taxation would prevent further abandonment and help in assuring a future for private forestry. However, local governments were unwilling to relinquish a sizeable proportion of their tax base.

In 1927, a constitutional amendment was approved which allowed an exception from the uniformity in taxation clause for forest land. Later that year, the Forest Crop Law (FCL) was enacted. Under the FCL, land is taxed at a constant annual rate while timber is taxed only when harvested. A similar program, the Woodland Tax Law (WTL), was enacted in 1954 to extend tax benefits to owners of small wood lots. (Enrollment peaked in 1985 at 475,000 acres. The last WTL contracts expired in 2000.)

During the first 25 years, only about 200,000 of the approximately 10 million acres of private forest land was enrolled under the FCL. The low enrollment was due in part to the annual acreage share payment of 10 cents per acre offered little incentive when compared to the level of property taxes. However, as property taxes increased and the savings offered by the "acreage share" payment also increased, so did participation in the program. By 1985, when the program was closed, about 1.5 million acres were enrolled. In 2001, about 450,000 acres remained under the program.

The Managed Forest Law (MFL) program was enacted to replace the FCL and WTL. In 2001, about 2,080,000 acres were enrolled under the MFL. Part of the rationale behind the MFL was to encourage enrollment by non-industrial forest land owners. Experience under the FCL indicated that non-industrial land owners objected to the public access requirements. The MFL attempts to ease this concern by allowing land owners to pay an additional fee for the right to close off up to 80 acres to public access.

Provisions of the Forest Crop Law (FCL)

Under the FCL, an owner of a complete quarter-quarter section (typically 40 acres) in a town or village could petition the Department of Natural Resources (DNR) to enroll that land in the program. If the DNR determined that forestry was the best use for that land and that there was reasonable assurance a stand of merchantable timber would be produced within a reasonable period of time, the land was accepted into the program. Contracts were for 25 or 50 years, at the landowner's option. The contract obliged the owner to practice forestry on the land, to notify the DNR of planned timber harvests, to allow state appraisals of harvested products, and to open the land for public hunting and recreational activities. Land enrolled under the program is exempt from property taxes. Owners are required to make an annual "acreage share" payment to the town or village. When timber is harvested, owners are required to pay a severance tax to the state equal to 10% of the value of the harvested forest products. The FCL contract provides for certain penalties if the owner fails to comply with the contract or elects to withdraw from the program before expiration of the contract.

1. **Acreage Share.** Land owners are required to make an annual payment to the municipality in which the land is located. The municipality must share 20% of the payment with the county. On land entered prior to 1972 the payment is 10 cents per acre. On land entered under a special provision (in effect from 1949 to 1963 outside DNR fire control boundaries) the payment is 20 cents per acre. On land entered since 1972, the payment in 1994 to 2003 is 83 cents per acre, computes as 20 cents times the following ratio:

$$\frac{\text{Aggregate Land Value in the State in 1992} = \$43,966,567,000}{\text{Aggregate Land Value in the State in 1972} = \$10,544,826,600} = 4.1695$$

The ratio will be recalculated in 2002; the revised payment will be used to determine payments in 2004.

2. **State Contribution.** The DNR annually pays the municipality 20 cents per acre of FCL land within its jurisdiction, of which the municipality shares 20% with the county.
3. **Severance Tax.** Every year, the DNR holds public hearings to establish values for various types of timber harvested across the state. When timber on FCL land is harvested, the volume is multiplied by the stumpage value, and the severance tax applied to the result. From the severance tax on a given parcel, the DNR retains an amount equal to the sum of the annual payments it has made to the municipality on that parcel. Any excess is paid to the municipality, which must share 20% with the county.
4. **Withdrawal Tax.** Land can be withdrawn from the FCL program at the owner's option or by DNR order if the owner has not complied with the FCL contract. In either case, the owner must pay a withdrawal tax. This tax equals the sum, over the period the contract was in effect, of the differences between the amount of real estate taxes that would have been levied on the land and the acreage shares and severance taxes actually paid. Each year's difference is also subject to simple (not compound) interest at 12% per year (5% for pre-1977 contracts) for each year the real estate tax has been deferred. From the withdrawal tax, the DNR retains an amount equal to the sum of state payments for that parcel to the municipality. The balance is remitted to the municipality, which must share 20% with the county.
5. **Contract Expiration.** When a contract expires and is not renewed, a severance tax of 10% of the value of the standing timber is assessed. The tax is distributed in the same manner as regular severance taxes.

Provisions of the Managed Forest Law (MFL)

An owner of ten or more contiguous forest acres in a town or village may apply for entry into the MFL program. Landowners sign a 25- or 50-year contract and must follow a forest management plan. Enrolled land is generally open to public hunting and recreational access. However, landowners can opt to close up to 80 acres to public access by paying an annual closure fee.

1. **Acreage Share.** For 1999 to 2003, the payment is 74 cents per acre, equal to the original payment (74 cents) multiplied by the ratio of the average statewide tax per acre on agricultural, swamp and waste, taxable forest land, and other land payable in 1997 divided by the corresponding average for 1986. The payment will be recalculated in 2002, with the revised amount effective for payments in 2004. The municipality must share 20% of the payment with the county.
2. **Closure Fee.** For payments due in 1999 to 2002, the closure fee is \$1 per acre. This fee is recalculated at five-year intervals (using the original payment of \$1 per acre) by the same ratio used to determine the acreage share payment. The entire closure fee is remitted to the state Conservation Fund for use by DNR in its land acquisition and resource management activities.
3. **State Contribution.** The DNR pays the municipality 20 cents per year for each MFL acre. The municipality must share 20% of the state contribution to the county.
4. **Yield Tax.** The yield (severance) tax for MFL land is 5% of the value of the merchantable timber cut. The DNR retains half of the yield tax and distributes the other half to the municipality in which the timber was cut.

5. **Withdrawal Tax.** On withdrawal from the MFL program, the land owner must pay the greater of (a) the real estate taxes that would have been levied on the land minus the acreage shares and yield taxes actually paid, or (b) 5% of the stumpage value of the merchantable timber on the land. The DNR retains 50% of any withdrawal tax and remits the other 50% to the municipality where the withdrawn land is located.
6. **Contract Expiration.** When a contract expires and is not renewed, the land becomes subject to the property tax.

Measuring the Tax Reduction under Forest Tax Programs

There are two tax effects attributable to forest tax programs. The first is the estimated tax savings that accrue to program participants. The second is the effect on property tax levies attributable to the special tax programs. Since local units may receive increased state aids in addition to in-lieu payments and payments from program participants, the net effect on property tax levies is not equal to the tax savings of participants. In this report, only the tax savings to program participants is discussed.

In Table 1, the tax that would have been paid on land enrolled under the forest tax laws is termed the "Initial Tax Reduction". It was estimated by (1) multiplying the average net tax per acre on *taxable* forest land in each municipality by the number of acres enrolled under the forest tax laws in that municipality, and (2) summing these figures across the state for each forest tax law. The amount per acre is the state total under the forest tax law divided by state total acreage enrolled under that program.

The statewide average net tax per acre of *taxable* forest land for 2001/02 was \$15.23 per acre. The "Initial Tax Reductions", for 2001 were \$13.17 per acre under the FCL and \$14.89 per acre under the MFL.

"Landowner Payments" are subtracted from the "Initial Tax Reduction" to determine the "Net Tax Reduction." Payments under the FCL are "Acreage Share", "Severance Tax", and "Withdrawal Tax". Payments under the MFL are "Acreage Share," "Closure Fee," "Yield Tax" and "Withdrawal Tax."

As Table 1 shows, the "Net Tax Reductions," or tax savings in 2001/02 were: under the FCL, about \$11.41 per acre, for a total of \$5.1 million; and under the MFL, about \$12.87 per acre, for a total of \$26.8 million. The total initial tax reduction under the programs is about \$36.9 million. The total net tax reduction under the programs is about \$31.9 million, or about 86% of the total initial tax reduction.

TABLE 1
FINANCIAL ANALYSIS OF FOREST TAX LAWS, 2001/02

| Item | Forest Crop Law* | | Managed Forest Law | |
|--------------------------|------------------|----------|--------------------|----------|
| | Amount | Per Acre | Amount | Per Acre |
| Initial Tax Reduction | \$5,896,429 | \$13.17 | \$30,966,658 | \$14.89 |
| Landowner Payments: | | | | |
| Acreage shares | 186,418 | 0.42 | 1,538,506 | 0.74 |
| Closure fees | 0 | 0 | 908,538 | 0.44 |
| Severance/yield taxes | 251,647 | 0.59 (*) | 923,293 | 0.44 |
| Withdrawal taxes | 350,382 | 0.78 | 837,062 | 0.40 |
| Total Landowner Payments | \$ 788,447 | \$1.76 | \$4,207,399 | \$2.02 |
| Net Tax Reduction | \$5,107,982 | \$11.41 | \$26,759,259 | \$12.87 |
| Acres enrolled | 447,673 | | 2,079,062 | |

(*) Per acre figure for FCL reflects the exclusion of about 23,000 acres of "Special Classification" land on which severance taxes are not assessed. Severance taxes paid on conversion of FCL land to MFL land are included.

Evaluation

As discussed earlier, the forest tax laws were enacted to help rebuild and sustain the state's private forestry resources. Although this has arguably been accomplished, it is not clear to what extent these programs have contributed to this outcome. Property taxes remain a major concern to forest land owners. The recreational land market offers an important alternative for forest land, but prices in that market bear little relation to the land's ability to produce commercial forest products. As recreational demand has increased, property tax levels on taxable forest land are increasing rapidly. For an owner of forest land interested in pursuing forestry, the forest tax laws are an increasingly attractive way to ease the tax burden. However, the potential for profit from selling the land into the recreational market may be overwhelming. As a result, total acre enrollment has stabilized despite increased taxes, as seen on Table 2.

TABLE 2
ACRES ENROLLED AND AVERAGE PROPERTY TAX ON FOREST LAND, 1929 - 2001

| Year | Acres Enrolled | | | | Average Property Tax per Acre of Taxable Forest Land |
|------|---------------------|--------------------|-----------------------|-------------------------|--|
| | Woodland Tax Law | Forest Crop Law | Managed Forest Law | Total Acres Enrolled | |
| 1929 | 0 | 203,534 | 0 | 203,534 | \$0.63 |
| 1939 | 0 | 144,190 | 0 | 144,190 | 0.40 |
| 1948 | 0 | 182,705 | 0 | 182,705 | 0.43 |
| 1955 | 0 | 208,158 | 0 | 203,158 | 0.52 |
| 1960 | 60,431 | 361,211 | 0 | 421,642 | 0.52 |
| 1965 | 107,431 | 490,154 | 0 | 597,585 | 0.56 |
| 1970 | 154,185 | 643,514 | 0 | 797,699 | 0.87 |
| 1975 | 158,302 | 951,808 | 0 | 1,110,110 | 1.42 |
| 1980 | 256,349 | 1,287,833 | 0 | 1,544,182 | 3.31 |
| 1985 | 447,851 | 1,468,912 | 0 | 1,916,763 | 5.90 |
| 1990 | 472,236 | 1,452,194 | 372,102 | 2,296,532 | 6.87 |
| 1995 | 302,338 | 1,406,718 | 804,269 | 2,513,325 | 7.76 |
| 1996 | 259,629 | 1,305,356 | 962,657 | 2,527,642 | 6.82 |
| 1997 | 204,356 | 1,259,275 | 1,080,344 | 2,543,975 | 7.45 |
| 1998 | 148,294 | 1,116,514 | 1,255,182 | 2,519,990 | 8.66 |
| 1999 | 100,351 | 519,688 | 1,905,679 | 2,525,718 | 10.31 |
| 2000 | 55,507 | 471,727 | 1,971,474 | 2,498,708 | 12.90 |
| 2001 | 0 | 447,673 | 2,079,062 | 2,526,735 | 15.23 |

Sources:

Acreage -- 1929-48: Erling Solberg, *New Laws for New Forests*, University of Wisconsin Press, 1961, page 430. 1955-1985: Wisconsin Department of Natural Resources, Forestry Tax Unit. 1990-2001: State totals from Statements of Assessment filed with the Wisconsin Department of Revenue.

Tax per Acre -- 1929-48: Solberg, page 454. 1955-2001: Calculated by the Wisconsin Department of Revenue.

It is difficult to measure the extent to which forestry practices or forest outputs have been affected by the programs. Of the 10 million acres of forest land in private ownership, only about 25% of that is enrolled under the forest tax laws. A major question is why 75% of this land is not enrolled.

The cost effectiveness of the MFL program can be questioned. Based on the data on severance and yield taxes in Table 1, the value of timber harvested from land under the MFL averages \$8.80 per acre per year (\$0.44/5%). After paying the acreage shares and related payments, the average tax savings is about \$13.29 per acre. Thus, the value of the timber harvested is less than the value of the annual tax savings (or, in economic terms, the tax subsidy) provided to forest land owners under the programs.

The economic concerns should be considered together with the non-monetary benefits from the MFL program. Such benefits include making land available for public hunting and fishing, the contribution to the local economy of work in the forests, and the availability of local sources of raw materials for local wood production industries.

REAL ESTATE TRANSFER FEE

Introduction

The real estate transfer fee was enacted in response to the repeal of the federal stamp tax. The fee became effective in 1969. It applies to transfers of real estate ownership interests located in Wisconsin.

All real estate conveyances not excluded or exempted by statute are subject to the fee. Payment of the fee is the responsibility of the seller ("grantor") of the property interest. The rate is 30 cents for each \$100 of value or fraction thereof. On conveyances that are gifts or for nominal consideration, value is the estimated price the property would have sold for on the open market. On other conveyances, value is the full consideration paid for the property plus any liens on the property.

Value data from real estate transfer fee returns is the Department of Revenue's main source of information for determining changes in the fair market value of real property in the state. This information is used in the annual process of determining assessment/sales ratios and equalized values.

Collections

The fee is payable to the county register of deeds when the deed or instrument of conveyance is recorded. However, the fee for land contracts is due when the land contract is recorded. For most transfers, completion of a real estate transfer return and payment of the appropriate fee is a prerequisite for the register of deeds to record the transaction. Each month, the county transfers 80% of the fees to the Department of Revenue. The state's share of the fees during FY02 was about \$50.8 million and counties' share was \$12.7 million.

Exemptions by the 2001 Legislature

The 2001 Legislature enacted two new exemptions from the real estate transfer fee for certain business reorganizations. One exemption applies to partnerships that register as limited liability partnerships. The other exemption applies to conversions of limited partnerships, limited liability companies, business corporations, and non-stock corporations to other forms of business if, after the conversion, the ownership interests in the new entity are identical to the ownership interests in the entity immediately preceding the conversion.

Analysis of Exemptions

A fiscal effect is difficult to estimate for some exemptions because a transfer return is not required or there is no consideration for the transfer. The primary data source for the value of real estate transfers exempt from the real estate fee consists of the returns filed with the Department of Revenue in calendar year 2001 on which an exemption was claimed. Unlike past years, the data for 2001 includes transfers in the City of Milwaukee. The fiscal effects shown below are for the portion of the real estate transfer fee paid to the state. The effect on county revenues is one-fourth of the state fiscal effect.

REAL ESTATE TRANSFER FEE EXEMPTION DEVICES SUMMARY

| Exemption Device | Statutory Reference* | FY02 Fiscal Effect |
|---|---------------------------------|--------------------|
| Easements | s. 77.21 (1) | Not available |
| Leases for less than 99 Years | s. 77.21 (1) | Not available |
| Conveyances Prior to October 1, 1969 | s. 77.25 (1) | 48,000 |
| Conveyances by Government Bodies | s. 77.25 (2) | 308,000 |
| Gifts to Governments | s. 77.25 (2g) | 13,000 |
| Land Dedications and Highways | s. 77.25 (2r) | 2,000 |
| Confirmation, Correction, or Reformation of Prior Conveyances | s. 77.25 (3) | 1,593,000 |
| Conveyances for Delinquent Taxes | s. 77.25 (4) | 15,000 |
| Conveyances on Partition | s. 77.25 (5) | 179,000 |
| Conveyances Pursuant to Certain Business Mergers or Reorganizations | s. 77.25 (6), (6d), (6m) | 215,000 |
| Conveyances by Subsidiary Corporation to Parent | s. 77.25 (7) | 288,000 |
| Conveyances Between Family Members | s. 77.25 (8) and (8m) | 7,714,000 |
| Conveyances Between Agent and Principal | s. 77.25 (9) | 950,000 |
| Conveyances to Release Debt | s. 77.25 (10) | 397,000 |
| Conveyances by Will, Descent, or Survivorship | s. 77.25 (11) | 249,000 |
| Conveyances on Condemnation | s. 77.25 (12) | 66,000 |
| Real Estate Valued at \$100 or Less | s. 77.25 (13) | 17,000 |
| Conveyances by or in Lieu of Foreclosure | s. 77.25 (14) | 774,000 |
| Conveyances Between Business Entities and Their Owners | s. 77.25 (15), (15m), and (15s) | 2,787,000 |
| Conveyances to Certain Trusts | s. 77.25 (16) | 4,501,000 |
| Fulfillment of Land Contract | s. 77.25 (17) | None |
| Transfers to a Local Exposition District | s. 77.25 (18) | 2,000 |
| Conveyances from a Fiduciary to an Unincorporated Nonprofit Association | s. 77.25 (20) | None |
| Electric Transmission Facilities and Land Rights | s. 77.25 (21) | None |

*References to sections of the 2001 Wisconsin Statutes.

Easements

Easements are excluded from the definition of conveyances subject to the real estate transfer fee. No real estate transfer fee return is therefore required for easements.

Leases for Less than 99 Years

Leases for less than 99 years are excluded from the definition of conveyances subject to the real estate transfer fee. No real estate transfer fee return is therefore required for leases of less than 99 years.

Conveyances Prior to October 1, 1969

Conveyances made prior to October 1, 1969, (the date the fee went into effect) are exempt from the fee and from filing a transfer fee return. The fiscal effect is therefore understated.

Conveyances by Government Bodies

Conveyances from the United States, the state of Wisconsin, or from an instrumentality, agency, or subdivision of either, are exempt from the fee. Such conveyances are also exempt from filing a real estate transfer fee return unless the governmental entity is also a lender for the transaction. Since most sales by government entities are exempt from filing a real estate transfer fee return, the fiscal effect is understated.

Gifts to Governments

Conveyances in the form of gifts to the United States, the state of Wisconsin, or to an instrumentality, agency, or subdivision of either, are exempt from the fee.

Land Dedications and Highways

Conveyances or dedication in a subdivision plat or certified survey for the purpose of a road, street, or highway to the United States, the state of Wisconsin, or to an instrumentality, agency, or subdivision of either are exempt from both the fee and from filing a transfer fee return. Because these transfers are exempt from filing a transfer fee return, the fiscal effect is understated.

Confirmation, Correction, or Reformation of Prior Conveyances

Conveyances that confirm, correct, or reform a conveyance previously recorded for nominal, inadequate, or no consideration are exempt from the fee.

Conveyances for Delinquent Taxes

Conveyances on sales for delinquent taxes or assessments are exempt from the fee and are also exempt from filing a transfer fee return. Therefore, the fiscal effect is understated.

Conveyances on Partition

Conveyances on partition of real estate are exempt from the fee.

Conveyances Pursuant to Certain Business Mergers or Reorganizations

Conveyances pursuant to mergers of corporations are exempt from the fee. Beginning on October 1, 2002, conveyances pursuant to a partnerships reorganizing as a limited liability partnership will be exempt from the fee. Beginning on October 1, 2002, conveyances pursuant to conversions of limited partnerships, limited liability companies, business corporations, and non-stock corporations to other forms of business will be exempt from the fee if, after the conversion, the ownership interests in the new entity are identical to the ownership interests in the entity immediately preceding the conversion.

Conveyances by Subsidiary Corporation to Parent

Conveyances by a subsidiary corporation to its parent for no consideration, nominal consideration, or in sole consideration of cancellation, surrender, or transfer of capital stock are exempt from the fee.

Conveyances Between Family Members

Conveyances between husband and wife, parent and child, stepparent and stepchild, parent and son-in-law, or parent and daughter-in-law for nominal or no consideration are exempt from the fee.

Conveyances Between Agent and Principal

Conveyances between agent and principal or from a trustee to a beneficiary without actual consideration are exempt from the fee.

Conveyances to Release Debt

Conveyances to provide or release security for a debt or obligation are exempt from the fee. However, for original land contracts filed before August 1, 1992, a transfer fee will be assessed when the documents relating to fulfillment of the land contract are filed.

Conveyances by Will, Descent, or Survivorship

Conveyances by will, descent, or survivorship are exempt from the fee and exempt from filing a real estate transfer fee return. The fiscal effect is therefore understated.

Conveyances on Condemnation

Conveyances pursuant to or in-lieu of condemnation are exempt from the fee.

Real Estate Valued at \$100 or Less

Conveyances of real estate having a value of \$100 or less are exempt from the fee.

Conveyances by or in Lieu of Foreclosure

Conveyances under a foreclosure or a deed in lieu of a foreclosure to a person holding a mortgage or to a seller under a land contract are exempt from the fee.

Conveyances Between Business Entities and Their Owners

Conveyances between a corporation and its shareholders, a partnership and one or more of its partners, or a limited liability company (LLC) and its members are exempt if the transfer is for no consideration other than the assumption of debt or stock or other interest in the business entity and all of the stock or other ownership interest is owned by persons who are related to each other as spouses, lineal ascendants or descendants, siblings, or spouses of siblings. Corporations and LLCs are eligible for the exemption only if the business entity has owned the property for at least three years.

Conveyances to Certain Trusts

Conveyances to a trust are exempt if a transfer from the grantor to the beneficiary of the trust would be exempt under other provisions of the real estate transfer fee law (section 77.25, Wis. Stats.).

Fulfillment of Land Contract

The recording of deeds in fulfillment of a land contract is exempt from the real estate transfer fee if the proper fee was paid when the land contract was recorded. (The fee on land contracts filed before August 1, 1992, is deferred until the contract is fulfilled. The fee on land contracts filed after July 31, 1992, is due when the contract is filed.) The intent of this provision is to prevent two fees from being imposed on the same land contract transaction. Therefore, this exemption does not reduce state revenues.

Transfers to a Local Exposition District

Transfers of property to a local exposition district organized under Subchapter II of Chapter 229, Wis. Stats., are exempt from the fee.

Conveyances from a Fiduciary to an Unincorporated Nonprofit Association

Conveyances from a fiduciary which held property for the benefit of an unincorporated nonprofit association to the unincorporated nonprofit association in the association's own name are exempt.

Electric Transmission Facilities and Land Rights

Conveyances of transmission facilities or land rights for transmission facilities by a utility company to a transmission company in exchange for securities in the transmission company are exempt from the real estate transfer fee. One transmission company, American Transmission Company (ATC), began operations in January 2001. Most of the state's largest electric utilities joined ATC and transferred their transmission assets in 2001.

TAXATION OF PUBLIC UTILITIES

Background

Prior to the early 1900s, each municipality valued and taxed public utility property located within its borders. This caused major problems as utility service territories expanded to cover several municipalities.

In 1905, the state began valuing railroad property under the "unitary" concept whereby each railroad was valued as a whole, as opposed to separate values in each municipality. At the same time, the tax rate was switched from individual municipal tax rates to the statewide average tax rate. In 1908, street railway companies and their related light, heat, and power companies were brought under state taxation. In 1917, other light, heat, and power companies with property in more than one municipality were brought under this system; however, municipal tax rates continued to apply until replaced in 1929 with the state average rate. This system of taxation was extended to airlines in 1946 and to pipelines in 1950.

For some utility companies, the state tax is based on revenues instead of property values. Rural electric cooperatives, organized in the 1930s, were originally taxed on their property. However, in 1939, they were switched to a tax based on gross revenues. In 1985, private light, heat, and power companies were switched to a tax based on gross revenues. Telephone companies were taxed on their gross revenues until 1998, when they began a switchover to a property tax. In addition to the telephone property tax, local exchange companies and cellular telephone companies also paid a gross revenues-based tax during a 2-year transition period ending in 2000.

A utility serving retail customers whose customers and property are all located within a single municipality is assessed and taxed locally under the general property tax. However, if such a utility's primary business is selling electricity at wholesale and its generating plant(s) has/have a generating capacity of 50 megawatts or more, the utility is taxed under the state gross revenues tax.

Table 1 shows utility tax collections in FY02 for gross revenues and ad valorem taxpayers.

**TABLE 1
FY02 UTILITY TAX COLLECTIONS**

| Utility by Type of Tax | Collections |
|---|----------------------|
| Gross Revenues | |
| Carlines | \$ 465,024 |
| Electric Cooperative Associations | 8,586,399 |
| Municipal Light, Heat, and Power | 1,656,643 |
| Private Light, Heat, and Power | 143,134,141 |
| Ad Valorem - Unit Value | |
| Airlines | 5,440,902 |
| Conservation and Regulation Companies | 101,526 |
| Municipal Electric Association Projects | 1,273,139 |
| Pipelines | 10,260,440 |
| Railroads | 11,755,291 |
| Ad Valorem – Tangible Property Value | |
| Telephone Companies | 86,638,137 |
| TOTAL | \$269,311,642 |

Taxation Methods

Under gross revenues taxation, a company's tax liability is its gross revenues allocated to Wisconsin multiplied by a specified tax rate. Carlines are taxed at 3% of their gross revenues. Rural electric cooperatives are taxed at 3.19% of their gross revenues. Private light, heat, and power companies are taxed at 0.97% of their revenues from gas services and 3.19% of their revenues from electric and other services (primarily steam and water).

Under ad valorem taxation, utilities other than telephone companies are taxed on the basis of the portion of their unit value allocated to Wisconsin. This method is applied to railroads, airlines, pipelines, and conservation and

regulation companies. Municipal electric association projects (power systems owned by two or more municipal light, heat, and power companies) make an in-lieu of tax payment based on this method. The utility's value allocated to Wisconsin is multiplied by the net statewide average tax rate to determine the utility's tax liability. The net statewide average tax rate is calculated by dividing the total statewide property taxes levy minus the school levies credit by the statewide full market value of taxable property.

Under the telephone property tax, the real and personal property of each telephone company in a given municipality is taxed at the prior year's net tax rate applicable in that municipality.

**TABLE 2
PUBLIC UTILITIES TAX EXEMPTION DEVICES SUMMARY**

| Exemption Device | Statutory Reference * | FY02 Fiscal Effect |
|--|-------------------------------------|--------------------|
| Gross Revenues Exemptions | | |
| Power Purchased by Private Light, Heat, and Power Companies | s. 76.28 (1)(d) | 1,502,000 |
| Power Purchased by Electric Cooperatives | s. 76.48 (1g)(d) | 3,767,000 |
| Public Benefits Charges | ss 76.28 (1) (d) and 76.48 (1g) (d) | Not available |
| Transmission Company Revenues from Wisconsin-taxed Utilities | s 76.28 (1)(d) | 4,590,000 |
| Ad Valorem Exemptions | | |
| Hub Airlines | s. 70.11 (42) | 2,200,000 |
| Motor Vehicles - Generally | s 76.025 (1) | 179,000 |
| Motor Vehicles - Telephone Companies | s. 76.81 | Not available |
| Treatment Plant and Pollution Abatement Equipment - Generally | s 76.025 (1) | 305,000 |
| Treatment Plant and Pollution Abatement Equipment – Telephone Companies | s. 76.81 | 0 |
| Computers - Generally | s. 76.025 (1) | 122,000 |
| Computers - Telephone Companies | s. 76.81 | Not available |
| Fax Machines and Cash Registers - Generally | s. 76.025 (1) | 0 |
| Fax Machines and Cash Registers - Telephone Companies (exempt beginning 1/1/03) | s. 76.81 | 0 |
| Telephone Company Property Used Less Than 50% for Telephone Purposes (exempt beginning 1/1/03) | ss. 70.112 (4) (b) and 76.81 | 0 |

* References are to the 2001 Wisconsin Statutes.

GROSS REVENUES EXEMPTIONS

Power Purchased by Private Light, Heat, and Power Companies

Private light, heat, and power companies may deduct from their gross revenues tax base an amount equal to the following percentages of their cost of power purchased for resale:

- 100% if:
 - the company purchased more than 50% of the power it sells, and
 - the power was not purchased from a company with an "affiliated interest" (i.e., neither company may have an ownership interest in the other), and
 - the revenue from the purchased power was included in the seller's gross revenue as reported to the Wisconsin Public Service Commission (i.e., the seller is subject to Wisconsin's gross revenues tax).

- 50% if:
 - the company purchases more than 90% of its power, and
 - the company has less than \$50 million of gross revenues.

Power Purchased by Electric Cooperatives

Electric cooperatives may deduct from their gross revenues the cost of power purchased for resale if the cooperative meets one of the following tests:

- The cooperative purchases more than 50% of the power it sells, and the revenue from the purchased power is included in the seller's gross revenues, or
- The cooperative purchased more than 50% of the power it sold in 1987 from a seller located outside Wisconsin.

Public Benefits Charges

Private light, heat, and power companies' responsibilities for providing "public benefits" programs such as low-income energy assistance, energy conservation, and renewable energy assistance programs were transferred to the state. These programs are funded by a monthly "public benefits" fee utilities are required to collect from their customers and remit to the state. Electric cooperatives and municipal electric companies can either participate in the state programs or operate their own "public benefits" programs, with costs to be funded by a monthly fee from their customers. The first "public benefit" fees were charged in September 2000. These "public benefits" fees are excluded from the definition of revenue subject to the gross revenues tax. Under accounting rules followed by most of the state's utilities, the utility is considered the state's collection agent for the public benefits charges. The revenue is not considered as belonging to the utility and is therefore not shown in utility revenue statements. It is therefore not possible to reasonably estimate the revenue loss from this exemption.

Transmission Company Revenues from Wisconsin-taxed Utilities

Private light, heat, and power companies are encouraged to transfer ownership of their transmission lines to an independent transmission company in return for an ownership interest in that company. When calculating its gross receipts tax, a transmission company may exclude revenues for services provided to: (1) electric cooperatives organized under Wisconsin law that provide wholesale service to their members, (2) municipal light, heat, and power companies based in Wisconsin, and (3) private light, heat, and power companies which are subject to the state's gross revenues tax. One transmission company, American Transmission Company LLC, currently exists. It began operations on January 1, 2001.

AD VALOREM EXEMPTIONS

Hub Airlines

A provision of 2001 Wisconsin Act 16, the biennial budget bill, exempted property of a "hub airline" from the state ad valorem tax on airlines (as well as from local property taxes). An airline qualifies as a "hub airline" if in the prior year its activities meet either of the following: (1) out of a single Wisconsin airport, it operated at least 45 common carrier flights each weekday to at least 15 non-stop destinations, or (2) the airline company is headquartered in Wisconsin and it operated, from single airport or combination of Wisconsin airports, at least 20 common carrier flights each weekday. An airline exempt from taxes is not required to file financial statements with the Department of Revenue. However, based on the value for the 2000 levy and adjusting for depreciation, the revenue loss in FY 2002 is estimated to be \$2,200,000.

Motor Vehicles - Generally

Motor vehicles such as automobiles, trucks, and trailers owned by airline, pipeline, railroad, or conservation and regulation companies are exempt from the ad valorem utility tax but subject to registration fees in the same manner as other motor vehicles.

Motor Vehicles - Telephone Companies

Motor vehicles owned by telephone companies are exempt from the telephone property tax but subject to registration fees in the same manner as other motor vehicles. Telephone companies do not report the value, number nor type of motor vehicles and an estimate of the revenue loss under this exemption is not available.

Treatment Plant and Pollution Abatement Equipment - Generally

Property owned by airline, pipeline, railroad, or conservation and regulation companies used as a waste treatment facility to abate or eliminate the pollution of the water or air of the state is exempt from the ad valorem utility tax.

Treatment Plant and Pollution Abatement Equipment - Telephone Companies

Property owned by telephone companies used as a waste treatment facility to abate or eliminate the pollution of the water or air of the state is exempt from the ad valorem utility tax. Telephone companies did not own any such property in FY02.

Computers - Generally

Computers owned by airline, pipeline, railroad, or conservation and regulation companies are exempt from the ad valorem tax. The exemption took effect on January 1, 2000.

Computers - Telephone Companies

Telephone company computers that used for general business purposes are exempt from the telephone company property tax. The exemption first applied to property valuations for 1999. The Department does not require telephone companies to report the value of their exempt computers and an estimate of the fiscal effect of this exemption is not available.

Fax Machines and Cash Registers - Generally

Beginning in 2003, cash registers and fax machines, excluding fax machines that are also copiers, owned by airline, pipeline, railroad, or conservation and regulation companies will be exempt. This exemption had no effect on revenues for FY 2002.

Fax Machines and Cash Registers - Telephone Companies

Beginning in 2003, cash registers and fax machines, excluding fax machines that are also copiers, owned by a telephone company will be exempt. This exemption had no effect on revenues for FY 2002.

Telephone Company Property Used Less Than 50% for Telephone Purposes

Beginning in 2003, property that is used less than 50% in the operation of a telephone company will be exempt from the telephone property tax. Such property will, however, be subject to local property taxes. This exemption had no effect on revenues for FY 2002.